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MONTANA LEGISLATIVE HISTORY

Chapter 807 19 91

Bill H _____ S 333 Original bill & history ___C

H. Committee on Taxation			S. Committee on Taxation		
Hearing Date(s)	Apr 04	✓ C	Hearing Date(s)	Feb 14	✓ C
	Apr 08	✓ C			C
		C			C
		C			C
Date Out	Apr 08	✓ C		Feb 14	✓ C

Did this bill originate in an interim committee? ___Yes ___No

Committee _____ Report _____

Free Conference Committee Apr 22 ✓ C

3/04	REFERRED TO BUSINESS & ECONOMIC DEVELOPMENT		
3/19	HEARING		
3/20	COMMITTEE REPORT—BILL CONCURRED		
4/06	2ND READING CONCURRED	91	3
4/06	ON MOTION RULES SUSPENDED TO PLACE ON 3RD READING THIS DAY		
4/06	3RD READING CONCURRED	93	4
	RETURNED TO SENATE		
4/13	SIGNED BY PRESIDENT		
4/15	SIGNED BY SPEAKER		
4/15	TRANSMITTED TO GOVERNOR		
4/17	SIGNED BY GOVERNOR		
	CHAPTER NUMBER 447	EFFECTIVE DATE: 4/16/91	

SB 331 INTRODUCED BY FRANKLIN, ET AL.

REVISE LAWS RELATED TO COUNTY CORONERS, INQUESTS, AND INQUIRIES

2/08	INTRODUCED		
2/08	REFERRED TO JUDICIARY		
2/09	FIRST READING		
2/19	HEARING		
2/23	COMMITTEE REPORT—BILL PASSED AS AMENDED		
2/25	2ND READING PASSED	46	3
2/26	3RD READING PASSED	41	9
	TRANSMITTED TO HOUSE		
3/04	FIRST READING		
3/04	REFERRED TO JUDICIARY		
3/15	HEARING		
3/26	COMMITTEE REPORT—BILL CONCURRED AS AMENDED		
4/06	2ND READING CONCURRED	91	0
4/06	ON MOTION RULES SUSPENDED TO PLACE ON 3RD READING THIS DAY		
4/06	3RD READING CONCURRED	96	1
	RETURNED TO SENATE WITH AMENDMENTS		
4/17	2ND READING AMENDMENTS CONCURRED	49	0
4/18	3RD READING AMENDMENTS CONCURRED	49	0
4/23	SIGNED BY PRESIDENT		
4/24	SIGNED BY SPEAKER		
4/24	TRANSMITTED TO GOVERNOR		
4/26	SIGNED BY GOVERNOR		
	CHAPTER NUMBER 660	EFFECTIVE DATE: 10/01/91	

SB 332 INTRODUCED BY GAGE

PROHIBIT SALE OF SMOKELESS TOBACCO TO MINORS

2/08	INTRODUCED		
2/08	REFERRED TO PUBLIC HEALTH, WELFARE & SAFETY		
2/09	FIRST READING		
2/18	HEARING		
2/22	TABLED IN COMMITTEE		

SB 333 INTRODUCED BY GAGE

SPECIFY REQUIREMENTS FOR A MONTANA SHAREHOLDER WITH REGARD TO INDIVIDUAL INCOME TAX TREATMENT

BY REQUEST OF DEPARTMENT OF REVENUE

2/08	INTRODUCED		
2/08	REFERRED TO TAXATION		
2/09	FIRST READING		
2/09	FISCAL NOTE REQUESTED		
2/13	FISCAL NOTE RECEIVED		
2/14	HEARING		

2/14	FISCAL NOTE PRINTED		
2/15	COMMITTEE REPORT—BILL PASSED		
2/16	2ND READING PASSED	48	0
2/18	3RD READING PASSED	49	0
	TRANSMITTED TO HOUSE		
3/04	FIRST READING		
3/04	REFERRED TO TAXATION		
4/04	HEARING		
4/08	COMMITTEE REPORT—BILL CONCURRED AS AMENDED		
4/11	2ND READING CONCURRED	96	2
4/12	3RD READING CONCURRED	94	1
	RETURNED TO SENATE WITH AMENDMENTS		
4/17	2ND READING AMENDMENTS NOT CONCURRED	49	0
4/18	CONFERENCE COMMITTEE APPOINTED		
4/22	CONFERENCE COMMITTEE DISSOLVED		
4/22	FREE CONFERENCE COMMITTEE APPOINTED		
4/23	FREE CONFERENCE COMMITTEE REPORT NO. 1		
4/24	2ND READING FREE CONFERENCE COMMITTEE REPORT NO. 1 ADOPTED	49	0
4/24	3RD READING FREE CONFERENCE COMMITTEE REPORT NO. 1 ADOPTED	49	0
	HOUSE		
4/19	CONFERENCE COMMITTEE APPOINTED		
4/22	CONFERENCE COMMITTEE DISSOLVED		
4/22	FREE CONFERENCE COMMITTEE APPOINTED		
4/23	FREE CONFERENCE COMMITTEE REPORT NO. 1		
4/24	2ND READING FREE CONFERENCE COMMITTEE REPORT NO. 1 ADOPTED	100	0
4/24	3RD READING FREE CONFERENCE COMMITTEE REPORT NO. 1 ADOPTED	95	5
4/30	SIGNED BY PRESIDENT		
5/03	SIGNED BY SPEAKER		
5/03	TRANSMITTED TO GOVERNOR		
5/17	SIGNED BY GOVERNOR		
	CHAPTER NUMBER 807	EFFECTIVE DATE: 12/31/91	

SB 334 INTRODUCED BY HARDING, ET AL.
REVISE PERSONAL LIABILITY FOR COUNTY OFFICIALS WHO EXCEED BUDGETS

2/08	INTRODUCED		
2/08	REFERRED TO LOCAL GOVERNMENT		
2/09	FIRST READING		
2/19	HEARING		
2/22	COMMITTEE REPORT—BILL PASSED		
2/23	2ND READING PASSED	49	0
2/25	3RD READING PASSED	49	0
	TRANSMITTED TO HOUSE		
3/04	FIRST READING		
3/04	REFERRED TO LOCAL GOVERNMENT		
3/13	HEARING		
3/14	COMMITTEE REPORT—BILL CONCURRED		
3/14	PLACED ON CONSENT CALENDAR		
3/16	3RD READING CONCURRED	96	1
	RETURNED TO SENATE		
3/21	SIGNED BY PRESIDENT		
3/22	SIGNED BY SPEAKER		
3/23	TRANSMITTED TO GOVERNOR		
3/27	SIGNED BY GOVERNOR		
	CHAPTER NUMBER 194	EFFECTIVE DATE: 10/01/91	

SB 335 INTRODUCED BY NOBLE, ET AL.
REVISE EXCAVATION PROCEDURES NEAR UNDERGROUND

tax or similar tax. He explained an exhibit (Exhibit #2) he prepared to further explain Senate Bill 280.

Opponents' Testimony:

NONE.

Questions From Committee Members:

Senator Gage asked Jeff Miller if there was an estimate as to the delinquencies were. Mr. Miller explained there is approximately $8400 in delinquent accommodation tax, and a large telephone license tax is being protested. The balance he explained is not a serious issue of delinquencies. He estimated in aggregate and excluding the $84,000 for accommodation and the telephone at $4 million, delinquencies would be less than $100,000. Senator Gage what the nature of the telephone license tax protest was. Mr. Miller explained an outstanding telephone tax dispute against AT&T relative to back years, and relative to the question of whether or not the revenues the derived from providing equipment was part of their telephone business. The case is currently before STAB, and is expected to proceed through the appeals process.

Senator Harp asked Mr. Miller about the bed tax. Mr. Miller explained the accommodations tax due date now is the 30th day following the close of the quarter with withholding the last day of the month. Since it generally viewed as filing the last day of the month, penalties have been assessed and causes an unpleasant situation.

Senator Towe asked if it was the same language in each case. Mr. Miller explained they were attempting to do so. He explained where penalties and interest were cited the language was made uniform; where the law was silent on the issue language was offered.

Senator Towe asked about credit and refund. Mr. Miller told the Committee a person is entitled to a credit or refund if claim is made within five years of the due date of filing the return. The credit or refund would first be applied to any underpayment, the balance refunded with interest at the same rate the department charges (1% per month).

Closing by Sponsor:

Senator Brown closed on Senate Bill 280.

HEARING ON SENATE BILL 333

Presentation and Opening Statement by Sponsor:

Senator Delwyn Gage explained Senate Bill 333 would give corporations outside of Montana and operating in Montana the same

treatment for Sub S election purposes as Montana corporations. He explained if the corporation elects Sub S status for federal they will automatically elected Sub S status for state. The reasoning is not only standardization, but there are some large taxpayers in Montana who have elected federal status on out-of-state corporations. They are avoiding Montana tax. Another concern is when having a different election for Montana opposed to the federal there is a requirement of two accounts for each of the stockholders unless all the income is distributed.

Proponents' Testimony:

Jeff Miller explained Senate Bill 333 was attempting three major revisions. Corporations and shareholders would be required to be bound by the federal election. Under current law a federal Sub S can elect out for Montana purposes entitling the shareholders to an exception; instead of reporting their federal adjusted gross income they are taxed only an actual distributions. The same election is not available to out-of-state residents creating confusion. With SB 333 the federal election will control whether resident or non-resident; whether Sub S is operating in Montana or out-of-state. Further, filing and perfection is simplified for state purposes. Mr. Miller prepared an exhibit for clarification. (Exhibit #3)

Tom Harrison representing the Montana Society of Certified Public Accountants spoke in favor of Senate Bill 333. He told the Committee the society endorsed the legislation "solely on and limited to the basis" of simplification. He explained the members of their organization did not receive information relating to the bill until February 13. He felt there was not ample opportunity to determine any practical problems the bill could present. He told the Committee that would be available if necessary.

Opponents' Testimony:

Tim Wylder, attorney from Great Falls, Montana spoke in opposition to Senate Bill 333. He told the Committee he was appearing on his on behalf, as a taxpayer and as a tax practioner. He stated SB 333 had merits in simplification and clarification of language in procedure in election, but the substance of the rule is misplaced. He explained the revenue issues are misaddressed. He said the fact one can exclude from the Montana tax base federal adjusted gross income and then take a deduction from state income for the total amount of federal taxes paid, creates a problem. In his opinion it is not simply clarification. The rule currently was clear that individuals are not taxed on undistributed income from a foreign corporation. In 1987 several taxpayers had loses and persuaded the department to allow them to use these loses. He told the Committee he looked into this issue in depth when he had an opportunity to invest in foreign S corporation. Through reading the statute it was clear that as such time the corporation distributed its

income it was not taxable in Montana; when it was distributed it was taxable. He and his accountant asked the department if their understanding was correct, and were told at they were. He told the Committee aside from the revenue issues which he agrees needs to addressed, "this issue has been up in the air for them all along". He said it was his understanding this bill took the opposite position when requested.

Mr. Wylder raised another issue with regards to Senate Bill 61 which limits the ability to take advantage of losses to losses generated out of Montana activity. He told the Committee it was not fair to change the rule where one cannot take advantage of out-of-state losses but is taxed on out-of-state gains which are not distributed.

Mr. Wylder proposed amendments to Senate Bill 333 which would address the concerns of the department without changing the basic rule which he feels has been clear. (Exhibit #5) He told the Committee with the amendments he could support the bill.

Questions From Committee Members:

Senator Towe asked Mr. Miller about Senate Bill 61. Mr. Miller explained it was in regards to federal taxes on income not subject to Montana tax, especially with the calculation of "at operating loss". To pull out federal taxes associated to income not subject to Montana as it relates to the Sub S distributions may be fairly simple, but federal taxes associated to US interest, other income such as Indian income or military pay taxed at federal but not at state level would not sort out as simply.

Senator Towe asked about Mr. Wylder's point of disallowing the loss but not waiting until the income comes into Montana. Mr. Miller told the Committee the deductible of federal taxes is only a portion of the problem. Tracking is a problem. The state will not see the return or the K1 that associates to that return or the 1099s because there will no 1099s. A distribution that show on the K1 filed for federal purposes but will not be provided to Montana because the state has no nexus with the corporation. There is no ability to follow that income back into the state.

Senator Towe asked if the corporation with a Montana Stockholder filing under Sub S elsewhere could be required to file a copy of the K1 with Montana. Mr. Miller explained there was no authority to force compliance with a Sub S in another state.

Senator Towe asked if there would be inconsistency in treatment in one way by disallowing the loss by passing SB 333. Mr. Miller explained the loss is not being disallowed under Senate Bill 61. Federal taxes associated or that would create that loss if it is associated income not taxable in the state of

Montana are being disallowed. The loss is still allowable under SB 61.

Senator Towe asked if then "we have disallowed the federal tax as a deduction which was not the same thing as disallowing a loss from the Sub S". Mr. Miller told the Committee that was correct.

Senator Thayer commented it did not seem fair taxpayers should have to pay tax on undistributed income, because it may never be distributed. For instance, what if the Sub S corporation through financial trouble while the tax is being paid for several years, and the income is not distributed.

Mr. Miller explained the unique entity dealt with is one that is chosen not to be taxed on its earnings at the entity level but rather to the individual level. It is not a situation of holding them to a higher standard of tax. The earnings from that activity are going to be taxed somewhere. For federal purposes they are taxed at the individual level; for state purposes they should also be taxed at the state level as earned because there are no tax at the corporate level.

Senator Towe asked Mr. Wylder if in Senate Bill 61 of only the deductibility of federal taxes, for federal purposes, (and in another state very likely as a Sub S corporation) why is it not fair or just to do so in Montana in all instances. Mr. Wylder told the Committee the federal government (assuming residents of Montana or the United States) will receive its tax no matter which state a person is in. He explained that at the state level it makes more sense to wait until distribution.

Senator Towe asked Mr. Wylder if his real concern hurting someone in the change-over. Mr. Wylder explained it is a matter of expectations. What exists now (somewhat limited by Senate Bill 61) with the old rule v. the new rule should not effect revenue in principle. The rule being proposed is losses can be recognized from out-of-state subject to limitations of Senate Bill 61, and the gains must be recognized. He explained the former rule was the opposite. He told the Committee his position the former rule "worked fine". The administration was "not a nightmare". The 1% of taxpayers in the situation had accountants keeping track. He explained taxpayers have made plans based on a well-established rule.

Senator Towe asked Mr. Miller about the point made by Mr. Wylder that taxpayers made investments on the former understanding. Mr. Miller told the Committee there had been a change because an individual came forward asking to include losses. Through an administrative hearing the individual prevailed. Since that time the have proceeded on this basis. If Senate Bill 333 passes an effective date for years after December 31, 1991, would cause the need for transition because there would be no grandfathering. At that point past timing differences

would be reconciled. He admitted investments strategies would be changed.

Senator Towe asked if there would be need for a statutory recognition of the transition. Mr. Miller commented it would not have to be dealt with statutorily. Senate Bill 333 would say for purposes of income tax, all years beginning after December 31, 1991, reporting would be on the same basis as federal.

Ward Shanahan, a Helena attorney told the Committee he was in support of Mr. Wylder's amendment. He commented about a statement from the American Spectator magazine regarding tax policy which says, "the tax policy often does not result in the redistribution of income, it results in the redistribution of taxpayers". He told the Committee he would be available to discuss Mr. Wylder's amendment.

Mr. Wylder told the Committee he was not sure the state would be entitled to tax distributions related to formerly taxed income at the federal level. He said Senate Bill 333 current attributable income would be tracked as the federal level. Therefore if distribution comes from a foreign S corporation there are no mechanics that would recognize it. He explained now the rule is clear, when it comes in it is taxable; but that is not what Senate Bill 333 says.

Senator Towe asked if it were not true there should be a rule to do so. If a rule is promulgated saying any income from a S corporation that has not been taxed because of previous ruling of the department it is now subject to tax as paid.

Closing by Sponsor:

Senator Gage closed on Senate Bill 333.

EXECUTIVE ACTION ON SENATE BILL 115

Motion:

Senator Van Valkenburg moved the amendments on the "gray bill". In addition, he moved striking Section 5 sub (4), and adding to sub 2 a new sub (c) saying "property tax revenue shall be distributed to the local governments based on the situs of the property".

Senator Towe offered a substitute motion to adopt all amendments, with the exception to the proposed addition to the new sub (c). He moved the following language for (c): "Property tax shall be distributed to the county treasurer for county purposes only, unless by agreement, a different distribution is presented within the proposal."

ROLL CALL

SENATE TAXATION COMMITTEE

DATE 2/14/91

____ LEGISLATIVE SESSION ____

NAME	PRESENT	ABSENT	EXCUSED
SEN. HALLIGAN	P		
SEN. ECK	P		
SEN. BROWN	P		
SEN. DOHERTY	P		
SEN. GAGE	P		
SEN. HARP	P		
SEN. KOEHNKE	P		
SEN. THAYER	P		
SEN. TOWE	P		
SEN. VAN VALKENBURG	P		
SEN. YELLOWTAIL	P		

Each day attach to minutes.

S.B. 333

REGULAR CORPORATION

PROFITS/LOSSES

TAXABLE AT CORPORATION LEVEL

Distributed Dividends

TAXABLE AT SHAREHOLDER LEVEL

SENATE TAXATION
EXHIBIT NO. 3
DATE 2/14/91
BILL NO. SB 333

S CORPORATION

Qualifications

- 35 Shareholders
- 1 Class of Stock

Key Features

- Pays no tax at federal level
- Pays $10 flat fee for Montana purposes
- To qualify as a Montana Sub S must elect for federal and for state §15-31-201

PROFITS/LOSSES PASS THROUGH

- Whether distributed or not - included in shareholder Federal AGI

TAXABLE AT SHAREHOLDER LEVEL

S CORPORATION

CURRENT LAW

ELECTION

MT TAX TREATMENT
§ 15-31-202

T. REGULAR

Exception
§ 15-30-111

TAXABLE AT
ORPORATE LEVEL 6 3/4%

DISTRIBUTED
DIVIDENDS

TAXABLE AT
SHAREHOLDER
EVEL (Only on
actual distribution)

MT. S CORP

$10.00 Fee

PROFITS/LOSSES

TAXABLE AT
SHAREHOLDER
LEVEL

NON MONTANA S CORP

Elected for Federal

EXEPTION NOT AVAILABLE
NO NEXUS TO ELECT OUT

PROFITS/LOSSES

Reported By
MONTANA RESIDENT
SHAREHOLDER
(Included in their Fed. AGI)

CURRENT DEPARTMENT PRACTICE

Based on 1987 legal opinion - Department has consistently treated shareholder in out of state S Corps as being bound by Federal election.

1). Exception in § 15-31-111 not available.

2). Rely on our tie to Federal AGI - allow out of state Sub S losses - require out of state Sub S income be included

FEATURES OF SB0333

1). This bill will require this treatment for all Sub S Corporations and all resident shareholders. In other words, federal election controls state treatment - whatever is in shareholder's federal AGI is in MT AGI per § 15-31-111.

2). Election process for state is simplified - they attach a copy of federal election to first return filed. Continue to pay $10.00 flat fee in lieu of corporate tax.

3). Affirm the principle, residents taxed on 100% of income - to the extent taxed in another state they are allowed a credit against Mt. liability.

SENATE BILL 333
FACT SHEET

STATE TREATMENT OF S CORPORATION

- OF THE FORTY FIVE (45) STATES THAT TAX CORPORATIONS, FIVE STATES DO NOT RECOGNIZE S CORPORATION STATUS

  THESE FIVE STATES ARE:

  CONNECTICUT
  MICHIGAN
  NEW HAMPSHIRE
  NEW JERSEY
  TENNESSEE

- OF THE FORTY (40) STATES THAT RECOGNIZE S CORPORATION STATUS, EIGHT (8) STATES REQUIRE A SEPARATE ELECTION AT THE STATE LEVEL. THE OTHER THIRTY TWO (32) STATES FOLLOW THE ELECTION MADE AT THE FEDERAL LEVEL.

- ONLY TWO STATES ALLOW THE OPTION TO ELECT OUT OF S CORPORATION STATUS (CALIFORNIA & WISCONSIN)

MONTANA S CORPORATION BREAKDOWN

- 21,500 CORPORATIONS FILE RETURNS WITH THE CORPORATION TAX DIVISION

- OF THE 21,500 CORPORATIONS, A LITTLE OVER 25% OR 5,400 OF THESE ARE S CORPORATIONS.

- OF THE 5,400 S CORPORATIONS, BETWEEN 1 & 2% ELECT OUT OF BEING A S CORPORATION FOR MONTANA PURPOSES AND FILE AS A REGULAR CORPORATION FOR MONTANA PURPOSES (BETWEEN 50 & 100)

State of Montana

Stan Stephens, Governor

Department of Revenue
Denis Adams, Director

Income and
Miscellaneous Tax Division
Jeff Miller, Administrator

February 12, 1991

MEMORANDUM

TO: House and Senate Tax Committees

FROM: Denis Adams, Director

RE: Analysis of Taxpayers Who Paid No Tax In 1988 And 1989

Last year, two separate studies were done on taxpayers who had a federal adjusted gross income in excess of $100,000 and yet, paid no Montana income tax. The first year that was looked at was 1988 and the second year was 1989.

In 1988 there were 26 taxpayers who had a federal adjusted gross income in excess of $100,000 and did not pay any Montana income tax. In 1989, there were 50 taxpayers who met the criteria and did not pay any Montana income tax. Only one taxpayer showed up in both studies. (26 + 50 - 1 = 75 distinct taxpayers.)

We then combined both studies and analyzed the 75 taxpayers' filings to look for consistent patterns occurring over the last two years' returns - 1988 & 1989. We found two different areas on the Montana return caused taxpayers to pay no Montana tax. These areas are the **adjustments from federal adjusted gross income** to arrive at Montana adjusted gross income and the **itemized deductions**. These areas are further analyzed below:

ADJUSTMENTS FROM FEDERAL AGI

The majority of income excluded as an adjustment from federal adjusted gross income fell into seven categories. The largest three categories are:

1. U. S. Interest Income
2. Out-Of-State S Corporation Income
3. Montana Net Operating Losses

The remaining categories are:

4. Indian Income
5. Active Duty Pay
6. Capital Gains Exclusion
7. Retirement Income

ITEMIZED DEDUCTIONS

The returns that paid no income tax either 1) contained itemized deductions in excess of the taxpayer's federal adjusted gross income, or 2) the combination of the taxpayer's adjustments and his itemized deductions exceeded his/her federal adjusted gross income. The largest two itemized deductions reducing the Montana adjusted gross income were the:

1. Federal tax deduction
2. Investment interest deduction

The remaining principal deductions are as follows:

3. Home Mortgage Interest Deduction
4. Personal Interest Deduction
5. Contribution Deduction, &
6. Medical Deduction

CONCLUSIONS

Out of the seventy five taxpayers returns filed we found:

53 paid tax in one of the two years;

22 paid no tax in either year.

Of the twenty two that paid no tax in either year, six were from the 1988 study and sixteen were from the 1989 study. There was no single consistent adjustment from federal adjusted gross income that would explain why they paid no tax. However, in looking at the itemized deductions, a consistent pattern of large federal tax deductions and home mortgage interest did stand out.

The analysis proved there is a high degree of variability of reasons to explain why a person could have high federal income and yet pay no Montana Income Tax. Of this population, 29% paid no tax in either year.

The following is a breakdown by year showing the number of taxpayers who paid no tax:

Taxpayers Selected Based On:	1988	1989
1988 Study	(26)	6
1989 Study	17	(50)
Total	43	56

The above breakdown does not count those taxpayers who were nonresidents and did not file Montana income tax returns because they did not have any Montana income. Of the twenty-six taxpayers in 1988, one was a nonresident in 1989 and of the fifty taxpayers in 1989, two were nonresidents in 1988.

One final comment, because the returns filed indicated no tax does not mean that there may not be tax owing. The project identified a number of potential audit issues which we will follow-up.

Attached are four schedules showing a further analysis of the returns by year.

Attachments

ANALYSIS OF 1988 RETURNS WITH FEDERAL ADJUSTED GROSS INCOME IN EXCESS OF $100,000 WHO PAID NO MONTANA INCOME TAX

# OF RETURNS	%	ANALYSIS OF RETURNS
4	15.4%	A combination of a large 2% miscellaneous deduction and federal tax, investment interest, savings bonds interest and retirement deductions zeroed out the tax liability in these returns.
2	7.7%	A combination of a large Montana Capital Gain deduction, federal tax paid and interest deducted.
1	3.8%	This return had a large Montana net operating loss combined with federal tax paid and interest deducted to offset his income.
2	7.7%	Two returns did not have any MT income tax liability because they had a large non Montana S corporation income exclusion and federal tax deduction which zeroed out their tax liability.
8	30.8%	Eight returns had a federal tax deduction that exceeded 100% of the MT adjusted gross income.
1	3.8%	One return did not have any MT income tax liability because the medical deduction exceeded their MT adjusted gross income.
1	3.8%	One return had a combination of investment interest & mortgage interest that exceeded 100% of the federal adjusted gross income.
7	27.0%	Seven returns combined itemized deductions and personal exemptions to exceed 100% of their MT adjusted gross income.
26	100.0%	

ANALYSIS OF 1989 RETURNS WITH FEDERAL ADJUSTED GROSS INCOME IN EXCESS OF $100,000 WHO PAID NO MONTANA INCOME TAX

# OF RETURNS	% OF RETURNS	ANALYSIS OF RETURNS
8	16.0%	Eight returns had a negative Montana adjusted income after subtracting out adjustments in arriving at MT AGI.
20	40.0%	Twenty returns had a federal tax deduction that was in excess of 100% of their MT adjusted gross income.
1	2.0%	One return had a medical deduction that was in excess of their MT adjusted gross income.
9	18.0%	Nine returns had two major deductions that when combined exceeded 100% of their MT adjusted gross income.The deductions were the federal tax deduction, contribution deduction, medical deduction, investment interest deduction or misc. deductions.
5	10.0%	Five returns have three major deductions when combined exceeded 100% of their MT adjusted gross income. The deductions were the federal tax deduction, investment interest deduction, contributions deduction, other taxes deduction, home interest deduction, medical deduction or misc. deductions.
2	4.0%	Two returns had up to six deductions when combined exceeded 100% of their MT adjusted gross income. The deductions were the federal tax deduction, other taxes deduction, home interest deduction, personal interest deduction, investment interest deduction, or contribution deduction.

ANALYSIS OF 1989 RETURNS (CONT.)

5	10.0%	Five returns had itemized deductions ranging from 89% to 98% of their MT adjusted gross income. When combined with their exemption deductions the result exceeded their MT adjusted gross income.
50	100.0%	

TOTAL ADDITIONS AND DEDUCTIONS FOR 1988 NON TAX FILERS

NO. OF RETURNS	26		25	
TAY YEAR	1988	%	1989	%
FED AGI	5,990,926	100.00%	8,181,071	100.0%
ADD				
NON MT. INT	112,118	1.9%	133,346	1.6%
FED REF.	189,763	3.2%	639,740	7.8%
TRUST INCOME	13,158	.2%		
LESS				
U.S. INT.	203,308	3.4%	260,319	3.2%
ELDERLY INT.	7,200	.1%	6,400	.1%
RETIREMENT	39,802	.7%	50,160	.6%
STATE REFUND	51,375	.9%	120,182	1.3%
CAPITAL GAINS	117,172	2.0%	74,023	.9%
S CORP. INCOME	1,662,531	27.8%	1,766,052	21.6%
N. O. L.	223,198	3.7%		
SOCIAL SECURITY			15,329	.2%
NON MT INCOME			1,697,968	20.8%
NON-MT. TRUST	6,608	.1%	9,777	.1%
NON-MT FIDUCIARY	16,505	.3%	5,062	.1%
UNEMPLOYMENT	2,090	.04%	1,536	.02%
FED. REF-NO BENEFIT	54,345	.9%		
MT AGI	3,908,673	100.0%	4,959,907	100.0%
FED. TAX	4,542,682	116.2%	1,404,602	28.3%
OTHER TAXES	67,066	1.7%	92,913	1.9%
HOME INT.	229,927	5.9%	219,867	4.4%
PERS. INT.	248,005	6.4%	67,754	1.4%
INVEST. INT.	422,732	11.3%	422,260	8.5%
CONT. DED	162,353	4.2%	193,185	3.9%
2% MISC. DED.	258,987	6.6%	176,829	3.6%
OTHER MISC.	7,749	.2%	10,000	.2%
MEDICAL			12,207	.3%
AMT. TAXABLE	(2,098,915)		2,281,948	
TAX LIAB.	-0-		279,935	

TOTAL ADDITIONS AND DEDUCTIONS FOR 1989 NON TAX FILERS

NO. OF RETURNS	48		50	
TAX YEAR	1988	%	1989	%
FED AGI	21,515,391	100.0%	9,483,353	100.0%
ADD				
NON MT. INT.	244,902	1.1%	275,192	2.9%
FED REF	199,236	.9%	56,098	.6%
TRUST INCOME	5,422	.03%	16,387	.2%
CAPITAL GAINS	25,884	.1%		
LESS				
U.S. INT	918,788	4.3%	1,601,216	16.9%
ELDERLY INT.	18,400	.09%	24,000	.3%
RETIREMENT	84,751	.4%	231,124	2.4%
STATE REFUND	38,539	.2%	230,153	2.4%
CAPITAL GAINS	81,900	.4%	114,719	1.2%
S CORP.	1,262,502	5.9%	1,404,334	14.8%
N.O.L.	1,999,119	9.3%	2,761,387	29.1%
SOCIAL SECURITY	8,001	.04%	14,257	.2%
NON MT INCOME	3,028,474	14.1%	102,328	4.2%
NON MT TRUST	88,283	.4%	132,189	1.4%
ACTIVE DUTY PAY	167,928	.8%	212,186	2.2%
INDIAN INCOME	513,847	2.4%	530,601	5.6%
MT AGI	13,780,303	100.0%	2,172,236	100.0%
FED. TAX	3,998,103	29.0%	4,341,243	199.9%
OTHER TAXES	103,170	.8%	142,595	6.6%
HOME INT.	218,140	1.6%	257,831	11.9%
PERS. INT.	21,220	.2%	15,784	.7%
INVEST. INT.	328,049	2.4%	1,122,916	51.7%
CONT. DED	320,001	2.3%	257,026	11.8%
2% MISC. DED.	53,388	.4%	103,626	4.8%
OTHER MISC.	23,850	.2%	24,220	1.1%
MEDICAL	84,142	.6%	173,418	8.0%
STANDARD DED.	2,032	.01%		
AMT. TAXABLE	8,200,156		(4,460,562)	
TAX LIAB.	1,391,743		-0-	

Timothy J. Wylder

Attorney At Law

305 Liberty Center
9 Third Street North
Great Falls, Montana 59401

(406) 453-1966

March 23, 1990

Mr. Denis Adams, Director
Department of Revenue
Sam Mitchell Building
Helena, Montana 59620

Dear Denis:

Thank you for the opportunity to discuss S corporation issues with you last Friday. I have set forth my legal analysis in the enclosed Memorandum of Law. Although I am an advocate in this matter, I truly believe that my analysis is the better one.

I would like to set forth in this letter what I might call my institutional fairness argument. Several years ago when my clients and I were contemplating some out-of-state business ventures and investments, Kent Borglum and I undertook the sort of analysis I have set forth in my Memorandum, and Kent confirmed it with senior Montana Department of Revenue personnel. They agreed with our treatment of this issue, so we went ahead and participated in the organization of several out-of-state corporations and managements and consented to S corporation treatment for them. Then, unbeknown to us, along comes Professor Eck with some out-of-state S corporation losses he wants to use, and the Department produces a summary, result-oriented legal opinion and changes the rules on us without an opportunity to be heard, all in the face of plain statutory language to the contrary.

This is manifestly unfair and severely undermines professionalism in tax planning and administration. As a tax professional from the private sector and as an appointee of Governor Stephens, this should be of special concern to you. Thus, even if the merits of the alternative rules were equal, fairness would dictate that the Department return to its former position and practice (before the Eck initiative), which we relied on in good faith. The legislative burden should be on the Eck's of the world who would change the plain language of the statute and established administrative practice.

Thank you very much for your time and consideration. If you have any questions, do not hesitate to call.

Very truly yours,

Timothy J. Wylder

cc: Kent Borglum

SENATE TAXATION
EXHIBIT NO. 4
DATE 2/14/91
BILL NO SB 333

MEMORANDUM OF LAW

March 23, 1990

FROM: Timothy J. Wylder, Attorney at Law

TO: Denis Adams, Director, Montana Department of Revenue

ISSUE

Issue: Whether a Montana resident individual recognizes income for Montana individual income tax purposes on the undistributed income of a foreign corporation that has a valid federal S corporation election, but which does not do business in Montana, and therefore cannot elect under MCA 15-31-202?

CONCLUSION

No. MCA 15-30-111(3) applies to this issue by its plain language and provides that such income is excluded from the shareholder's adjusted gross income. Even if MCA 15-30-111(3) does not apply, there is no authority to attribute the corporation's undistributed income to its shareholders.

I

ANALYSIS OF THE ISSUE

Montana individual income tax is imposed upon the "taxable income" of individuals subject to tax. MCA 15-30-103. "'Taxable income' means the adjusted gross income of a taxpayer less the deductions and exemptions provided for in this chapter." MCA 15-30-101(16). MCA 15-30-111(3) provides as follows (brackets and emphasis added):

> [1] In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect [2] but with respect to which the election provided for under 15-31-202, as amended, is not in effect, [3] adjusted gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S election were not in effect.

There are no other statutes directly addressing this issue. On its face and by its plain language MCA 15-30-111(3) clearly addresses the issue posed here and answers it in the negative. Our issue poses (1) "a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect," (2) "but with respect to which the election provided for under 15-31-202, as amended, is not in effect." The statute then provides (3): "adjusted gross income does not include any part of the corporation's undistributed taxable income . . . ." The only difference between the actual statutory language and the issue posed here is the reason that the corporation in this case has not elected under MCA 15-31-202, namely, that it is ineligible to do so under MCA 15-31-201 because it does not, by assumption, do business in Montana.

MCA 15-30-111(3) does not address the various reasons a corporation may not have filed a Montana S corporation election under MCA 15-31-202. A corporation may not have been eligible as in this case; it may have neglected to make the filing; or it may

have chosen not to elect because it is more advantageous under the respective rate structures to be treated as an S corporation for federal purposes and a C corporation for state purposes.

MCA 30-15-111(3) does not address any of the reasons for not electing S corporation treatment under MCA 15-31-202; it simply sets forth the resulting tax consequences. Accordingly, a strong argument can be made that such reasons are not relevant. If the reasons for non-election were relevant to the application of the rule, they would have been set forth in the statute. When a statute clearly answers a legal question on its face in plain language, there is no justification for speculating on the various cases the legislature may have actually contemplated. The Montana Supreme Court recently stated:

> We first note the general rule of statutory interpretation found in § 1-2-102, MCA, which states that legislative intent controls. Legislative intent is to first be determined from the plain meaning of the words used, and if interpretation of the statute can be so determined, the courts may not go further and apply any other means of interpretation. Boegle v. Glacier Mountain Cheese Co. (Mont. 1989) 777 P.2d 1303, ____, 46 St. Rep. 1389, 1391 (emphasis added).

Similarly, in a recent property tax case the Court recited:

> [T]he well accepted principle of statutory construction that the function of this Court is to interpret the intention of the legislature, if at all possible, from the plain meaning of the words used, and if the meaning of the statute can be determined from the language used, this Court is not at liberty to add or detract language from the statute in question. Department of Revenue v. Gallatin Outpatient Clinic, Inc. (Mont. 1988) 763 P.2d 1128, ____, 45 St. Rep. 2025, 2028 (emphasis added).

Therefore, because MCA 15-30-111(3) applies to the issue at hand in plain, clear language, no further analysis of legislative intent is required or justified.

II

ANALYSIS OF THE MEMORANDUM OPINION

Reference is made to a Department of Revenue Memorandum Opinion, dated October 14, 1987, concerning taxation of gains and losses from out-of-state S corporations. The Memorandum Opinion begins its analysis on page 3 by acknowledging that MCA 15-3-111(3) answers the issue posed here on its face, but the author characterizes such a reading as "strict and technical." Actually, a plain reading gives a plain answer as demonstrated above. If by "strict" the author means limited to its plain meaning, then so be it. It certainly does not require a technical reading to reach the plain result. Any person applying basic plain English logic will get the same result. Only by taking a technical approach can one begin to consider other alternatives. That approach, of course, is contrary to the plain meaning rule adopted by the Montana Supreme Court.

Having thus summarily disposed with the plain meaning approach as "strict and technical," the Memorandum Opinion poses the question: "[W]hether the legislature intended by enacting § 15-31-111(3) [sic] to exclude gains and losses from out-of-state 'S' corporations from the adjusted gross income of Montana residents." The Memorandum Opinion argues that had the legislature intended the statute to apply to the case at hand, namely, an S corporation not doing business in Montana, (1) "it would have been much more clear," and (2) "it could easily have set forth an absolute exclusion of such gains and losses . . . ."

Concerning part (1) of the argument, it was noted above that there are several reasons why a corporation with a valid federal S corporation election might have no S corporation election in effect under MCA 15-31-202. The legislature chose not to address any of the reasons in the statute. As argued above, this supports the view that the various reasons for non-election are not relevant. The legislature just set forth the tax consequences as a matter of policy. As to part (2) of the argument, the legislature did "set forth and absolute exclusion of such gains and losses . . . ." MCA 15-30-111(3) is absolute; there are no qualifiers concerning reasons for having no election in place.

The Memorandum Opinion then makes the "impossibility" argument as follows:

> In effect, an interpretation that out-of-state "S" corporation gains and losses are excluded by § 15-30-111(3) is interpreting this statute to require an impossibility.
>
> It is a well known maximum jurisprudence that "[T]he law never requires impossibilities." § 1-3-22, MCA. In fact, it is impossible for an out-of-state "S" corporation to effectively elect under 15-31-202, MCA. Therefore, the requirement is nonsensical. The more reasonable interpretation is that the statute only requires an election when the corporation is "doing business" in Montana.

There appear to be several flaws in this reasoning. First, the proposition in the first sentence is misstated. It is only by interpreting MCA 15-30-111(3) to include gains or losses that requires the impossibility, that is, an election by a corporation not doing business in Montana, which ipso facto is not eligible under MCA 15-31-201. But, properly stated, this argument proves the opposite. If interpreting the statute to require inclusion of

such gains and losses requires an impossibility, then the statute should not be interpreted that way; rather it should be interpreted to require exclusion of gains and losses.

The concept of "impossibility" may be misused here in any case. It is "impossible" for a corporation not doing business in Montana to elect under MCA 15-31-202, and, therefore, impossible for its Montana shareholders to include the gains and losses for such corporation. But that is only to say that the corporation is ineligible. Under Subchapter S of the Internal Revenue Code, it is impossible for any corporation to be a shareholder of an S corporation, but that does not mean that other shareholders of such a corporation should be given S corporation treatment to avoid the "impossibility" of being ineligible. There is no impossibility in this case; there is just ineligibility and a policy decision set forth in plain language that certain tax consequences follow from the absence of an election.

Note also that the requirement of "doing business in Montana" under MCA 15-31-201 makes perfect sense in its context, that is, Chapter 31, MCA concerning the corporation income tax. A corporation is subject to tax only if it is doing business in Montana. MCA 15-31-101. If a corporation is not doing business in Montana, there is no corporation tax, and thus, there is no need to elect not to be subject to it.

III

FURTHER ANALYSIS

At the beginning of the Memorandum we applied MCA 15-30-111(3) and the plain meaning rule of the Montana Supreme Court to the

current issue and concluded that a plain answer resulted and further analysis was not justified. In the previous Section we analyzed the arguments in the Memorandum Opinion that reached a contrary conclusion and found them wanting. Although we believe the plain language approach discussed in Section I of this Memorandum is dispositive of this issue, others may feel a need for a more technical approach.

Let us assume for the sake of argument that the legislature did not subjectively intend for MCA 15-30-111(3) to apply to S corporations not doing business in Montana; it just did not have this case in mind. The analysis does not end there, however. We must then ask what rule should apply in the case of S corporations not doing business in Montana? Is there a good reason to reach the opposite result as set forth in MCA 15-30-111(3)? Further statutory analysis and the basic principles of income taxation suggest not.

First, even if one assumes that MCA 15-30-111(3) was not originally intended to apply to S corporations not doing business in Montana, the courts frequently and properly apply existing statutes to analogous situations even if the statutes do not directly apply. The existing statutes are the most legitimate source of public policy from which the courts can make law in the absence of a directly applicable statute. MCA 15-30-111(3) is the only statute directly relevant to this case. Accordingly, a court would be more likely to apply this rule than to decide that the opposite rule should apply.

Further analysis of the corporate and individual tax statutes other than MCA 15-30-111(3) also leads one to conclude that undistributed corporate income cannot be attributed to the corporation's shareholders. Because the corporation in this case does not do business in Montana, it is not subject to the Montana corporation income tax as noted above. By what authority then are its Montana shareholders subject to tax on the corporation's undistributed income? There is no statute that requires this. Indeed, MCA 15-30-202 demonstrates that a special statute and an affirmative election are required to attribute the income of a corporation to its shareholders. Thus, unless a special statute provides to the contrary, a corporate entity is respected for tax purposes.

Is there something in Chapter 30, MCA, concerning individual income tax that causes a shareholder to be taxable on a corporation's undistributed income? MCA 15-30-101(7) provides as follows (emphasis added):

> "Gross Income" means the taxpayer's gross income for federal income tax purposes as defined in section 61 of the Internal Revenue Code of 1954 or as that section may be labeled or amended . . . .

MCA 15-30-111(1) provides in part as follows (emphasis added):

> Adjusted gross income shall be the taxpayer's federal income tax adjusted gross income as defined in section 62 of the Internal Revenue Code of 1954 or as that section may be labeled or amended . . . .

IRC § 62(a) provides in part as follows:

> For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions . . . .

Article IV. Section 4 of SB 333 is amended at page 12, line 19 in the same manner as Section 1 of SB 333 is amended in Amendment I above.

Article V. Section 7 of SB 333 is amended as follows:

Add to the end of the sentence at page 16, line 10 the following language:

"to the extent that the corporation's net income is subject to the tax imposed by this chapter without regard to this section."

EXHIBIT 3
DATE 4-4-91
HB SB 333

Amendments to Senate Bill 333
Third Reading Copy

Prepared by The Department of Revenue
(April 3, 1991)

1. Title, line 15
Following: "Purposes;"
Insert: "PROVIDING A LIMITED EXCEPTION ALLOWING CORPORATIONS THAT CURRENTLY USE S CORPORATION STATUS FOR FEDERAL FILING AND REGULAR CORPORATION STATUS FOR MONTANA TO CONTINUE THAT METHOD OF FILING."

2. Page 14, line 10.
Following ~~(1)~~
Strike: For purposes of this part,
Insert: Except as provided in 15-31-201 (2),

3. Page 14, Line 18.
Following "effective.
Insert: (2) A corporation that would otherwise be a small business corporation may continue to be subject to the taxes imposed by Title 15, Chapter 31 if all the following conditions are met:
(a) On [the effective date of this act] the corporation was doing business in Montana and had a valid federal Subchapter S corporation election but had not elected to be taxed as a Montana small business corporation.
(b) After [the effective date of this act] the corporation has not filed as a Montana small business corporation.
(c) The corporation files a corporate license tax return as required by 15-31-111 reporting all income or loss as determined under Title 15, Chapter 31 and attaches a copy of the federal Subchapter S corporate tax return.

PROPOSED AMENDMENTS TO SENATE BILL 333

SUBMITTED BY

TIMOTHY J. WYLDER

February 14, 1991

Article I. Add a New Section to SB 333 before Section 1. A new subsection to 15-31-111(2), MCA, is added and reads as follows:

"(2) Notwithstanding the provisions of the federal Internal Revenue Code of 1986, as labeled or amended, adjusted gross income does not include the following which are exempt from taxation under this chapter:

. . .

"(b) gains, profits, or income not actually or constructively received by a cash basis taxpayer from any corporation, insurance company, investment company, mutual fund, trust, or similar entity; for the purposes of this subsection, "constructively received" shall have the meaning generally understood in income tax accounting matters;"

Article II. Section 1 of SB 333 is amended as follows:

At page 4, line 18 of the SB 333, strike lines 18 through 22 and substitute the following language:

> "(3) In the case of a shareholder of a small business corporation as defined in 15-31-201, as amended, except as provided in 15-31-202, as amended, adjusted"

then continue at page 4, line 23 and following without deleting the language of 15-30-111(3), MCA, as it currently reads.

Article III. Add New Section to SB 333 following Section 2. Section 15-30-121(2), MCA, is amended to read:

"15-30-121. In computing net income, there are allowed as deductions:

. . .

"(2) federal income tax paid within the taxable year, but only to the extent that the federal income tax paid is attributable to income items included in the taxpayer's Montana adjusted gross income under 15-30-111;"

SENATE TAXATION
EXHIBIT NO. 5
DATE 2/14/91
BILL NO. SB333

[redacted] was a regular corporation for income tax purposes and assessed tax, interest, and penalties on the Corporation. (JCCS had filed their Montana corporate return as if it were an S-Corporation). The Department also forced amended returns for all shareholders (see your file on [redacted] for example) to remove items of corporate income, deduction and ITC as shown on the Schedule K-1's from the shareholder's personal returns. We have documentation on all of this in our files.

The bottom line, Denis, is that it appears to me that not only has the Department of Revenue given assurance verbally that our tax treatment is the correct one, but it has demonstrated by its own actions and assessments that we are right. How then can the Department take an opposite stand now?

We feel that we are correct with our views in this matter. We also feel that the Montana Code is clear as it is written and that there is no reason to wait for the next Legislative session to fix something that is not broken. It is black and white, not gray, and the Department agreed with us only a short time ago.

Please advise us as to the status of this situation and I will relay the information on to our clients. Thanks.

Sincerely,

JUNKERMIER, CLARK, CAMPANELLA, STEVENS, P.C.
Certified Public Accountants

K Borglum

Kent A. Borglum, CPA

COPY

Junkermier · Clark
Campanella · Stevens · P.C.
Certified Public Accountants

Ward F. Junkermier, CPA
George L. Campanella, CPA
Stone E. Paulson, Jr., CPA
Rick A. Frost, CPA
Robert E. Nebel, CPA
Joseph F. Shevlin, CPA
Ronald A. Taylor, CPA
Kent A. Borglum, CPA
Terry L. Alborn, CPA
William J. Eidel, CPA
Walter J. Kero, CPA

May 29, 1990

Denis L. Adams, Director
Montana Department of Revenue
Mitchell Building
Helena, MT 59624

Dear Denis:

Thanks for taking the time during tax season to meet with Tim Wylder and me on the non-Montana S-Corporation taxation issue. We have not heard anything from your department as to the status of your predicament, so we are assuming that your office is still working on it.

So that you know JCCS' position in this matter, I would like to briefly reiterate that we looked into this issue in the fall of 1986. In fact, our time sheets, phone logs and other documents show that our research was substantially done prior to October 12, 1986. When we were reviewing the tax aspects of forming these out-of-state corporations, I (personally) talked to Lynn Chenoweth to (1) confirm our interpretation of the applicable statutes and (2) discuss the character of any distributions taken. It is my understanding that he discussed the issue with someone else in your department prior to his final phone call to me.

Included in our research notes is documentation that this type of corporate setup is also in operation with California shareholders of a Nevada S-Corporation with the identical result your office advised us on; that is, no California tax on the S-Corporation income until the income is actually distributed. The income cannot be reflected on the individual's state tax return because the S-Corporation did not (and cannot) make a valid state S-Corporation election. If the legal opinion set forth by your department's attorney was correct, there would be no reason to need a form or procedure to elect S-Corporation status in Montana, would there?

*** PLEASE NOTE that this issue has been raised by your Department before. We have received permission from another one of our clients to recap the following scenario for you.

[redacted] treasurer for [redacted], filed a Federal S-Corporation election on October 31, 1980. He did not file properly for a Montana election. JCCS did not know about him filing for the election until after he had done it and so assumed he did everything correctly. The Department notified [redacted] in 1982 of the improper filing under MCA Section 15-31-202 and that it did not have a valid election for the fiscal year ended September 30, 1981. The Department concluded that [redacted]

One point of view is that since the out-of-state "S" corporation does not have an opportunity to elect under §15-31-202, MCA, the exclusion of gains and losses should not apply. The other point of view is that the statute requires an election and if it is not made, neither the losses or the gains can be included in adjusted gross income.

The issue is whether the legislature intended by enacting §15-31-111(3) to exclude gains and losses from out-of-state "S" corporations from the adjusted gross income of Montana residents. There are no legislative minutes available to use as guidance as to intent. However, it seems clear that if in fact this was the legislature's intent, it would have been much more clear. In other words, it could easily have set forth an absolute exclusion of such gains and losses rather than doing it in such a round-about manner. In effect, an interpretation that out-of-state "S" corporation gains and losses are excluded by §15-30-111(3) is interpreting the statute to require an impossibility.

It is a well known maxim of jurisprudence that "[T]he law never requires impossibilities." §1-3-222,MCA. In fact, it is impossible for an out-of-state "S" corporation to effectively elect under 15-31-202, MCA. Therefore, the requirement is nonsensical. The more reasonable interpretation is that the statute only requires an election when the corporation is "doing business" in Montana.

Therefore, it is my opinion that both gains and losses of an out-of-state "S" corporation should be included in a Montana resident's adjusted gross income.

Dah/jb

for Montana purposes. These corporations can not qualify for an election under §15-31-202 because they do not "do business" in Montana. Indeed, because no nexus exists they are not taxable by the state of Montana and have no need to file an election making them exempt from taxation.

A strict and technical reading of §15-30-111(3) indicates that because no Montana election is filed, the gains and losses from an out-of-state "S" corporation received by an individual in Montana would not be included in Montana adjusted gross income.

> §15-30-111(3). In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect but with respect to which the election provided for under 15-31-202, as amended, is not in effect, adjusted gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the said election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S election were not in effect.

It is my understanding from Erv Hall's memorandum of August 18, 1987 and from a conversation with him, that the division policy in the past has been to disallow the deduction of losses from out-of-state. "S" corporations when claimed by Montana residents. Additionally, I understand that in certain cases, gains from out-of-state "S" corporations may have been included in a Montana resident's adjusted gross income.

Also, based upon discussions with Erv, I understand that in the case of partnership income, which is another type of "passive" income, both gains and losses are included as part of an individual resident's adjusted gross income.

It seems clear, as Erv has stated, that the policy and practice of the Department needs to be consistent as between gains and losses from out-of-state "S" corporation income.

> corporation is not subject to the taxes imposed by this chapter and, with respect to such taxable years and all succeeding taxable years, the provisions of this part apply to such corporation; and (b) with respect to the taxable years of a shareholder of such corporation in which or with which the taxable years of the corporation for which such election is in effect end, the provisions of this part apply to such shareholder, and with respect to such taxable years and all succeeding taxable years, the provisions of this part apply to such shareholder.
> (3) An election under subsection (1) must be made in accordance with rules prescribed by the department of revenue.
> (4) This election is not effective unless the corporate net income or loss of such electing corporation is included in the stockholders' adjusted gross income as defined in 15-30-11.
> (5) Every electing corporation is required to pay the minimum fee of $10 required by 15-31-204.

Small business corporations are those corporations which are "doing business in Montana" and have made an election pursuant to subchapter S of Chapter 1 of the Internal Revenue Code. 15-31-201(1), MCA. They are commonly referred to as "sub-S" or "S" corporations.

The gain or loss from an "S" corporation flows through to the individual shareholder for both federal and state purposes and is included in the individuals' adjusted gross income. §15-30-111, MCA. However, pursuant to subsection (3) of §15-30-111, MCA, if a corporation which has filed a valid "S" election for federal purposes does not file an election for state purposes as required by §15-31-102, MCA, the gain or loss is not included in Montana adjusted gross income for the individual. Because no election has been filed in Montana the corporation is subject to the Montana Corporation License Tax and the gain or loss will be included in the income of that corporation.

The question which Erv Hall poses in his request for an opinion concerns "S" corporations having a valid election for federal purposes but which do not "do business" in Montana; have no nexus with Montana and therefore are not a "small business corporation"

COPY

MEMORANDUM OPINION REV/OLA 87-61

TO: Ken Morrison, Administrator
Income Tax Division

FROM: David W. Woodgerd, Chief Legal Counsel
Office of Legal Affairs

DATE: October 14, 1987

SUBJECT: Individual Income Tax - Taxation of gains and losses from out-of-state "sub-S" corporations

ISSUE

Should the gains and losses of an out-of-state "sub-S" corporation which are attributable to Montana residents be included in Montana adjusted gross income?

CONCLUSION

The gains and losses from out-of-state "sub-S" corporations received by Montana residents should be included in their adjusted gross income.

DISCUSSION

As you are well aware, Montana exempts small business corporations from its corporate license tax if they so elect and meet certain criteria.

> §15-31-202. Election by small business corporation. (1) A small business corporation may elect not to be subject to the taxes imposed by this chapter.
> (2) If a small business corporation makes an election under subsection (1), then: (a) with respect to taxable years of the corporation for which such election is in effect, such

The Montana individual income tax is clearly predicated on Section 61 of the Internal Revenue Code. Under the long established principles of IRC § 61, a cash basis taxpayer is not taxable on income unless is it actually or constructively received. A corporation's undistributed income is not actually or constructurally received by its shareholders (unless such income were indirectly applied to satisfy the shareholder's obligations, a case not presented here). IRC § 61 does not cause corporation income to be attributed to shareholders; that is accomplished only by the special provisions of Subchapter S of the Internal Revenue Code, IRC § 1366 in particular. Thus, there is no authority under IRC § 61 and derivatively no authority under MCA 15-30-101(7) to attribute a corporation's income to its shareholders.

In summary, this Section has argued that even if MCA 15-30-111(3) was not originally intended to apply to S corporations not doing business in Montana, it should be applied to them anyway as the closest applicable rule.

The last two paragraphs have demonstrated that even if we assume that the statute was not originally intended to apply to the facts of this case, there is no authority for attributing the income of a corporation to its shareholders in any case in the absence of an applicable statute to that effect.

REP. REAM asked **Geralyn Driscoll, DOR,** if they had any comments on this. **Ms. Driscoll** said that the DOR is supportive of SB 299.

REP. RANEY asked **Ward Shanahan** what would be the case where you would anticipate using this law. **Mr. Shanahan** said lets say the Legislature passes a new statute that is ambiguity to statute. The taxpayer takes one position and the DOR takes another. Rather than putting the taxpayer through the expense of an factual hearing, if you find out what the words mean, that could dispose of the issue. You take it to district court, the district court says "this is my decision on the issue". Usually with those types of issues, they have to go to the Supreme Court. So you get to the Supreme Court before you have to go through a three or four day hearing before the state Tax Appeal Board.

Closing by Sponsor:

REP. REAM made no closing statement.

EXECUTIVE ACTION ON SB 299

Motion/Vote: **REP. McCARTHY MOVED SB 299 BE CONCURRED IN.** Motion carried unanimously.

HEARING ON SB 333

Presentation and Opening Statement by Sponsor:

SEN. GAGE, Senate District 5, Cutbank, stated SB 333 is an act clarifying that a Montana shareholders of a corporation that is not incorporated in Montana and has not elected to be taxed as a Montana small business corporation, is subject to the same individual income tax treatment as a Montana shareholder of a corporation that is incorporated in Montana and has not elected to be taxed as a Montana small business corporation. He turned the explanation of SB 333 over to **Jeff Miller, DOR.** He provided the committee with amendments prepared by DOR which would grandfather those people who have cast their investment strategies and made plans and commitments on the bases of knowing that they would not have to file a Montana return. Recognizing that that was a legitimate concern DOR prepared amendments. He stated that he had no problems with them. **EXHIBIT 3**

Proponents' Testimony:

Jeff Miller, DOR, stated that DOR is in support of SB 333. The bill simplifies our existing law, it promote interstate uniformity, promotes equity, and it is good tax policy. He provided the committee with testimony which explained the difference between a Sub-S corporation and a C corporation. **EXHIBIT 4**

Gary Carlson, CPA, Helena, said he stood as a proponent because of the proposal to amend. The argument made by **Jeff Miller** on simplification is important. He stood in support of SB 333 as amended.

Mark Russell, Montana Society of CPA's, stood in support of SB 333.

Opponents' Testimony:

Tim Wylder, Attorney, Great Falls, provided written testimony. **EXHIBIT 5**

Ward Shanahan, Attorney, Helena, stated that as of December, 1990, DOR has not adopted a hard and fast decision on the issue. The problem he has with SB 333 is in the Title. The word "clarifying" is used. The word clarifying is a lawyer weasel word that has been given various interpretations by the Supreme Court. When you clarify something it means that this is the way we all believe it was. That is not the situation here. You are dealing with taxpayers who have done tax planning for themselves who are now faced with disputes with DOR, who under its own statute of limitation of 5 years wants to go back and reassess them for liabilities. He urged the committee to look at **Mr. Wylder's** proposed amendment.

Questions From Committee Members:

REP. THOMAS asked **Tim Wylder** if with the grandfather clause, doesn't that take most of the problems out of the bill. **Mr. Wylder** said yes as long as the Legislature as a body makes it clear that SB 333 is intended to address both of the issues raised. **REP. ELLISON** said his interpretation of what **Ward Shanahan** said is as long as they didn't go back the five years. **Mr. Shanahan** said that is the affect of the word "clarifying". It gives the DOR the ability to argue in a particular tax case that this is the way they have always meant it, but there is an ambiguity in the statute and we want to clarify that this is the way we have always done it.

CHAIR HARRINGTON asked **Jeff Miller** what his feeling is on **Mr. Wylder's** amendment. **Mr. Miller** said that he feels it changes considerably the intent of SB 333. It is addressing current law issue, and he is trying to bring into this discussion a completely separate issue. In fairness, the DOR in 1987 did change its position. **REP. ELLISON** asked if the changes in federal Sub-S affect Montana law. **Mr. Miller** said yes because DOR has followed lock-step. When they raised their shareholder limit, so did we.

Closing by Sponsor:

SEN. GAGE made no closing statement.

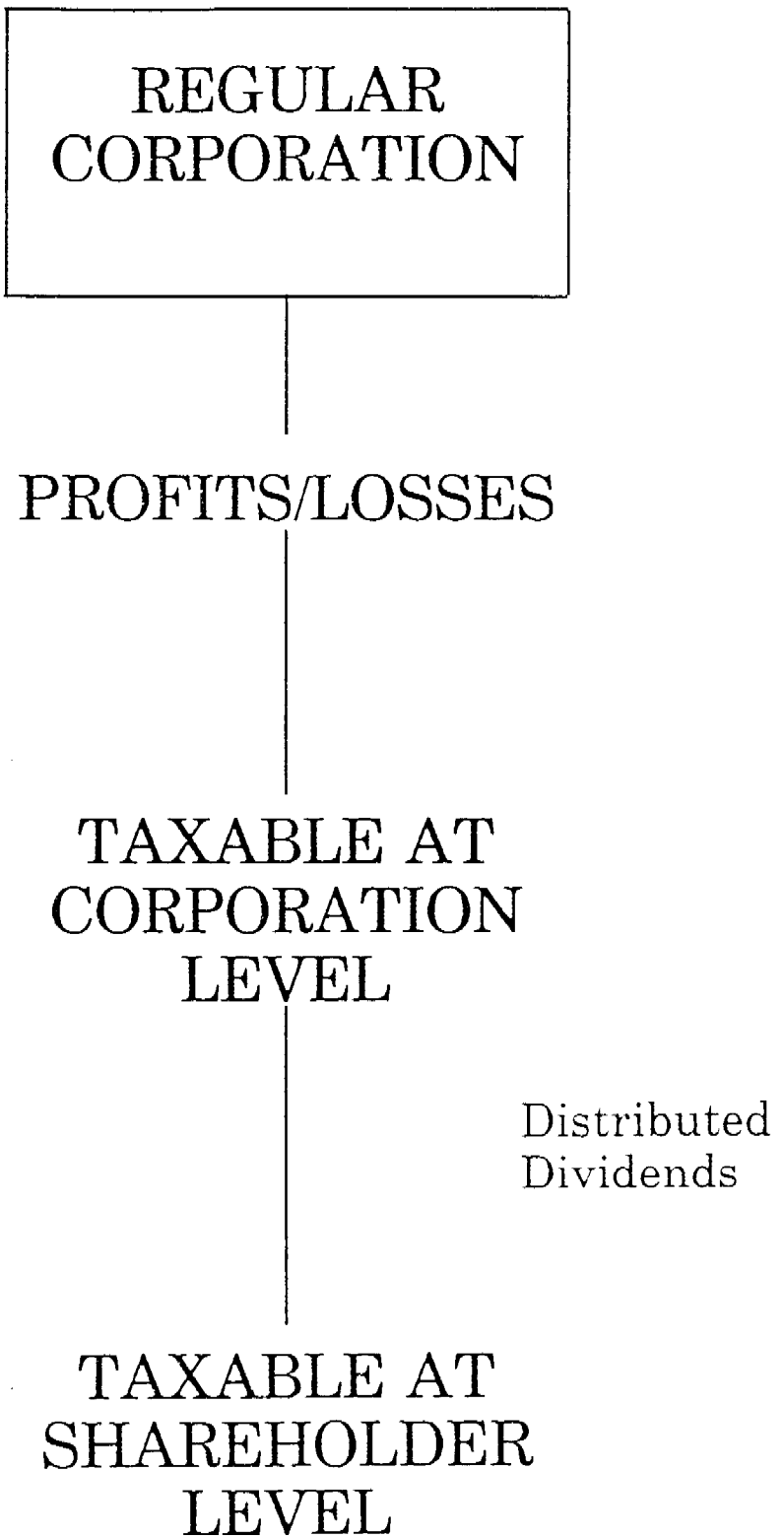
HOUSE OF REPRESENTATIVES

TAXATION COMMITTEE

ROLL CALL DATE 4-4-91

NAME	PRESENT	ABSENT	EXCUSED
REP. DAN HARRINGTON	✓		
REP. BEN COHEN, VICE-CHAIRMAN	✓		
REP. BOB REAM, VICE-CHAIRMAN	✓		
REP. ED DOLEZAL	✓		
REP. JIM ELLIOTT	✓		
REP. ORVAL ELLISON	✓		
REP. RUSSELL FAGG	✓		
REP. MIKE FOSTER	✓		
REP. BOB GILBERT	✓		
REP. MARIAN HANSON	✓		
REP. DAVID HOFFMAN	✓		
REP. JIM MADISON	✓		
REP. ED MCCAFFREE	✓		
REP. BEA MCCARTHY	✓		
REP. TOM NELSON	✓		
REP. MARK O'KEEFE	✓		
REP. BOB RANEY	✓		
REP. TED SCHYE	✓		
REP. BARRY "SPOOK" STANG	✓		
REP. FRED THOMAS	✓		
REP. DAVE WANZENRIED	✓		

EXHIBIT 4
DATE 4-4-91
HB SB333



DATE 2/14/91

COMMITTEE ON Senate Taxation

VISITORS' REGISTER

NAME	REPRESENTING	BILL #	Check One	
			Support	Oppose
Dave Woodgerd	DOR	279	✓	
[illegible]	DOR	280 279/333	✓	
Lloyd Brandon		333	AMEND	
James M Wylder	self	333		✓
Joseph F. SHERLIN		333		✓
Tim Wylder	self	333		
Dennis Burr	MT Taxpayers Assn	279 280	✓	
James Tutwiler	MT Chamber Commerce	SB 279	✓	
Ann Mary Dussault	MACo			

(Please leave prepared statement with Secretary)

Ex. 4
4-4-91
SB 333

Ex. 4
4-4-91
SB 333

ons

lareholders

ss of Stock

S CORPORATION

Key Features

- Pays no tax at federal level
- Pays $10 flat fee for Montana purposes
- To qualify as a Montana Sub S must elect for federal and for state §15-31-201

RP

.0.00 Fee

'S

PROFITS/LOSSES PASS THROUGH

- Whether distributed or not - included in shareholder Federal AGI

TAXABLE AT SHAREHOLDER LEVEL

EXHIBIT 4
DATE 4-4-91
HB SB 333

NON MONTANA S CORP

Elected for Federal

EXEPTION NOT AVAILABLE
NO NEXUS TO ELECT OUT

PROFITS/LOSSES

Reported By
MONTANA RESIDENT
SHAREHOLDER
(Included in their Fed. AGI)

CURRENT DEPARTMENT PRACTICE

Based on 1988 legal opinion - Department has consistently treated shareholder in out of state S Corps as being bound by Federal election.

1). Exception in § 15-31-111 not available.

2). Rely on our tie to Federal AGI - allow out of state Sub S losses - require out of state Sub S income be included

FEATURES OF SB0333

1). This bill will require this treatment for all Sub S Corporations and all resident shareholders. In other words, federal election controls state treatment - whatever is in shareholder's federal AGI is in MT AGI per § 15-31-111.

2). Election process for state is simplified - they attach a copy of federal election to first return filed. Continue to pay $10.00 flat fee in lieu of corporate tax.

3). Affirm the principle, residents taxed on 100% of income - to the extent taxed in another state they are allowed a credit against Mt. liability.

EXHIBIT 9
DATE 4-4-91
HB SB 333

Timothy J. Wylder
Attorney at Law
305 Liberty Center
9 Third Street North
Great Falls, Montana 59401

(406) 453-1966

April 4, 1991

Committee on Taxation
Montana House of Representatives

Re: Testimony on Senate Bill 333
Regarding Taxation of S Corporations

Mr. Chairman and Members of the Committee:

I practice business law and have dealt with the problems of small business taxation for over ten years. I am also personally involved with three S Corporations. Two are organized in Montana and do business in business in Montana; one is organized outside of Montana and does not do business in Montana. On behalf of myself and other Montana taxpayers similarly situated, I submit the following outline of my testimony in opposition to Senate Bill 333 as currently written and offer certain technical amendments to deal with my concerns.

I. **The Issue of Resident Shareholders of S Corporations Not Doing Business in Montana.**

Senate Bill 333 addresses a number of issues concerning Montana income taxation of S Corporations and their shareholders. One of the principal issues addressed by the Bill deals with Montana residents that own stock in S Corporations that are organized outside of Montana and do not do business in Montana. The issue has two parts and they are as follows:

1. Gains. Whether the Montana resident shareholder is taxable for Montana individual income tax purposes on the undistributed gains (income) of an out-of-state (foreign) S Corporation that does not do business in Montana?

2. Losses. Whether the Montana resident shareholder is allowed to use losses from a such a foreign S Corporation to reduce Montana taxes?

II. Current Law.

A. Section 15-30-111(3), MCA (1989). This Section provides in full as follows (See SB 333 at page 4-5) (emphasis added):

> In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect but with respect to which the election provided for under 15-31-202, as amended, is not in effect, adjusted gross income does not include any part of the corporation's

Ex. 5
4-4-91
SB 333

undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S election were not in effect.

This provision has been in the Montana Code since 1965.

B. **Interpretation.** There are no other statutes addressing this issue. On its face and by its plain language Section 15-30-111(3) clearly addresses both parts of the issue posed above and answers them in the negative. In short then, the current rule can be stated in short form as follows:

Part 1: Undistributed gains are excluded from Montana adjusted gross income (not taxed).

Part 2: Net operating losses are excluded from Montana adjusted gross income (do not reduce tax).

C. **Additional Support for This Interpretation.** As noted, the rule of Section 15-30-111(3) has been in effect since 1965. With the sole exception of the Department of Revenue personnel after 1987, the above interpretation has been accepted by every tax practitioner I have ever talked to about this issue, including Department of Revenue personnel before 1987. The Department's change of interpretation is discussed in Part III below. For further discussion of the above interpretation, see Exhibit A hereto, Excerpt from CCH Montana State Tax Reporter (1990) and Exhibit B hereto, "Memorandum of Law" from Timothy J. Wylder to Denis Adams dated March 23, 1990.

III. **The Department of Revenue Changes Its Position.**

A. **Prior to 1987.** Prior to 1987 the Department agreed with the above interpretation and confirmed its position to one of my CPA colleagues in connection with several corporations I was working with, including one of my own. See Exhibit C hereto, Letter from Kent Borglum, CPA to Denis Adams, dated May 29, 1990, regarding events of 1986.

B. **Events of 1987.** Sometime during 1987 a professor from the University of Montana School of Law persuaded a Department of Revenue hearings officer that, contrary to the plain language of Section 15-30-111(3), Part 2 of the rule set forth above, he should be allowed to used losses from an out-of-state S Corporation to reduce his Montana tax. The Department apparently acquiesced in this informal, unpublished decision. Subsequently, the Department's Legal Counsel issued an informal, unpublished Memorandum Opinion to justify the Department's change of position. See Exhibit D hereto, "Memorandum Opinion" from David W. Woodgerd to Ken Morrison, Administrator, Income Tax Division, dated October 14, 1987.

Note that with the exception of the taxpayer involved in the above case and Department personnel, no one knew, nor could anyone know by consulting published materials, that a change in the rules had purportedly taken place. Tax practitioners were presumably still advising their clients to take action based on the accepted rules of Section 15-30-111(3).

C. **Following 1987.** Based on its change of position in 1987, the Department in 1988 began assessing deficiencies against taxpayers with undistributed gains attributable to their ownership in foreign S Corporations. The Department's deficiency notices provided me with my first awareness that the Department had changed its position.

Note that even following the Department's 1987 change of position, unless a practitioner happened to have one of these unusual cases, he still would not have had any idea that the Department had changed its position. To the best of my knowledge, nothing was ever published by Department on this issue. Accordingly, if the issue came up, a practitioner would have advised that the rules of Section 15-30-111(3) apply as set forth above, that is, gains and losses are excluded in computing Montana adjusted gross income.

D. **Contested Cases.** Not surprisingly, taxpayers who had relied on the plain meaning of Section 15-30-111(3) and Department's assurances before 1987--in purchasing or investing in such corporations, making tax elections, and planning accordingly--contested the Department's new position.

IV. **Senate Bill 333--Requested by the Department of Revenue.**

A. **Background.** To resolve the controversy surrounding the issues raised above, and to its credit, the Department decided to seek legislative "clarification" on the issue. The Department worked with the Legislative Oversight Committee on Taxation and discussed a number of proposals. Then the Legislative Session began. The first draft out of Legislative Council confirmed what I take to be current law (contrary to the Department's post 1987 position), that is, gains and losses were to be excluded. In short, the old rules were to be retained.

In the meantime, however, support arose among certain legislators for reversing the current rules; they thought it was simpler if gains and losses were to be included. Senate Bill 333 was redrafted accordingly and introduced. As can be seen at pages 4-5 of the Bill, the language of Section 15-30-111(3), MCA (the old rule) has been deleted. The Bill went to hearing with very little scrutiny by tax practitioners. The Montana Society of CPA's testified that they favored it only because of its simplicity for future years and noted that its members had not had time to study it in any depth. The Bill

summarily passed the Senate Tax Committee and the full Senate with little further discussion.

B. **Merits of the Current Bill.** The Department will have testified as to the merits of the Bill. I will address their points briefly in light of what they say today. One thing is clear, however, simplicity is not served by changing a rule that taxpayers in many contexts have relied on for 25 years.

C. **Problems with the Current Bill.** As noted above, regardless of the merits of one set of rules over the other, by changing the rules in the middle of the game, Senate Bill 333 is manifestly unfair and creates tax headaches for taxpayers in many different S Corporation cases that have arranged their affairs and made their tax elections based rules in existence for 25 years.

1. **Examples.**

2. **Problems Magnified by the Tax Reform Act of 1986.** As a result of changes in federal corporation taxation in 1986, S Corporations have become much more desirable for profitable businesses. Accordingly, many S Corporation elections have been made since 1986 in Montana and elsewhere with regard to Montana.

3. **Problems Compounded by No Notice of Department's Change.** The many more S Corporation elections made after 1986 were all made without a clue that the Department had changed its position on Montana taxation of S Corporations and would seek legislation to confirm it.

D. **Solutions to the Problems.**

1. Kill the Bill and go back to the old rules.

2. Pass the Bill with the new rules, but allow for transition rules that will allow (and require in adverse cases) taxpayers who relied on the old rules to live by well established tax strategies, for better or worse. Losses and gains will vary by taxpayer.

V. **Proposed Amendments. See Exhibit E.**

A. **Title of the Bill.** The Title of the Bill should be amended to reflect the content of the Bill. As it now stands, the Title language reflects the first draft position that would have confirmed what I believe to be current law. It appears that when the Department changed its approach and a revised Bill was introduced, the Title was not revised to match the content of the Bill. Not only is the word "clarifying" not appropriate in my view, but the rule described in the first clause of the Title does not match the content of the Bill as introduced.

B. **Transition Rule.** Section 11(1) as amended would provide an acceptable transition rule for existing S Corporations and their shareholders in many situations that have arranged their affairs and made their tax elections based on 25 years of prior law.

C. **Technical Changes.**

1. Section 11(2) as amended would clarify that the Department is authorized to make administrative rules to implement the transition rules. authorized.

2. Section 11(3) is added to establish the supremacy of Senate Bill 333 in coordinating the Bill with other bills that may inadvertently address the tax law provisions affected by this Bill.

EXHIBIT A

EXHIBIT 5
DATE 4-4-91
HB SB 333

Other Adjustments

[¶ 15-470] **Other Montana Adjustments to Federal Adjusted Gross Income.**—In computing Montana adjusted gross income, other adjustments must be made to federal adjusted gross income as well as those additions and subtractions discussed above. These adjustments may be either "additions" or "subtractions," depending upon the taxpayer's situation.

An income adjustment between spouses may be made for income from a proprietorship if the proprietor's spouse performed services for the business. This adjustment is discussed at ¶ 15-472 below.

A shareholder of a Subchapter S corporation must also make certain adjustments to federal AGI, which are discussed at ¶ 15-474 below.

[¶ 15-472] **Adjustments for Spouses Filing Separate Returns.**—If a husband and wife file separate returns, each must report his or her own adjusted gross income. Income from personal services performed as an employee or as an independent contractor must be reported by the spouse who earned it. Income from rents, royalties, dividends, and interest must be reported by the spouse who owns the property from which the income is derived. If property is jointly owned by spouses, the income from it must be allocated according to each spouse's legal right to the income.

The income from a proprietorship business must be reported in full by the spouse who is the proprietor. If, however, the proprietor's spouse regularly and systematically renders substantial personal services to the business and is not paid a salary, the proprietor and the spouse may agree that the spouse earned an amount equal to reasonable compensation for services rendered, and that amount is deemed taxable to the spouse rendering the service rather than to the proprietor (.06).

A special rule is applied to married taxpayers who file a joint federal income tax return and who must include part of their social security benefits or part of their tier 1 railroad retirement benefits in federal adjusted gross income. Such married taxpayer may split the federal "base" used to calculate federal taxable social security benefits or federal taxable tier 1 railroad retirement benefits when they file separate Montana income tax returns (.01). The federal base must be split equally on the Montana returns (.01). The federal base is $32,000 for a joint return and $25,000 for a single return. A portion of the taxpayer's social security benefits or tier 1 railroad retirement benefits is subject to federal taxation if the taxpayer's "modified adjusted gross income" plus one-half of such social security or tier one railroad retirement benefits exceed such "base" amounts.

.01 MCA 15-30-111(6), ¶ 94-932c.

.06 ARM 42.15.322, ¶ 19-133.

.17 **IRA deductions**—The Technical Corrections Act of 1988 has changed the amount married people filing separately may be able to claim as an IRA deduction. The Act makes the instructions in the Montana tax booklet for 1988 on IRA's outdated. Under the old law, if a married person filed separately the IRA limitations applied only if that person was eligible for or covered by a qualified pension plan. Under the new law, even if a married person files separately, he or she is automatically considered covered by a qualified pension plan if his or her spouse is and, thus, they are subject to the IRA limitations. *Notice to Tax Practitioners*, Department of Revenue, February 23, 1989.

[¶ 15-473] **Adjustments for Senior Citizens.**—A taxpayer who is at least 65 years old is entitled to subtract from his or her federal adjusted gross income all interest income of up to $800 if filing separate return or $1,600 if filing a joint return (.01).

.01 MCA 15-30-111(2) ¶ 94-931.

[¶ 15-474] **Adjustments for Shareholders of Subchapter S Corporations.**—The law provides:

Law 15-30-111. * * * (3) In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of

Exhibit # 5
4-4-91 SB 333

Law

1954, as amended, is in effect but with respect to which the election provided for under 15-31-202, as amended, is not in effect, adjusted gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the said election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S. election were not in effect.

Shareholders of small business corporations which have elected to be taxed under Subchapter S for federal income tax purposes, but have not made the corresponding election under Montana law for state income tax purposes, must *add back to their federal AGI* the following items in computing their Montana AGI: Any actual distributions received from an electing small business corporation if the dividends would have been taxable for federal purposes had the corporation not made the Subchapter S election.

Shareholders must *subtract from their federal AGI* the amount of any undistributed taxable income, net operating loss, capital gains, or other gains, profits, or losses passed through to the shareholders by small business corporations which have elected to be taxed under Subchapter S for federal purposes but have not made the corresponding state election.

[¶ 15-476] Adjustments for Estates and Trusts.—The law provides:

Law

15-30-135. Tax on beneficiaries or fiduciaries of estates or trusts.— (1) A tax shall be imposed upon either the fiduciaries or the beneficiaries of estates and trusts as hereinafter provided, except to the extent such estates and trusts shall be held for educational, charitable, or religious purposes, which tax shall be levied, collected, and paid annually with respect to the income of estates or of any kind of property held in trust, including:

(a) income received by estates of deceased persons during the period of administration or settlement of the estate;

(b) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(c) income held for future distribution under the terms of the will or trust;

(d) income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of a minor, to be held or distributed as the court may direct.

(2) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts, whether the fiduciary or the beneficiaries are taxable with reference to the income of such estate or trust. In cases under subsections (d) and (e) of subsection (1), the fiduciary shall include in the return a statement of each beneficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

(3) In cases under subsections (a), (b), and (c) of subsection (1), the tax shall be imposed upon the fiduciary of the estate or trust with respect to the net income of the estate or trust and shall be paid by the fiduciary.

If the taxpayer's net income for the taxable year of the estate or trust is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate or trust for any accounting period of such estate or trust ending with the fiscal or calendar year shall be computed upon the basis on which such beneficiary's net income is computed. In such cases, a beneficiary not a resident shall be taxable with respect to his income derived through such estate or trust only to the extent provided in 15-30-131 for individuals other than residents.

(4) The fiduciary of a trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund

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Exhibit # 5
4-4-91 SB 333
EXHIBIT 5

MEMORANDUM OF LAW

March 23, 1990

FROM: Timothy J. Wylder, Attorney at Law

TO: Denis Adams, Director, Montana Department of Revenue

ISSUE

Issue: Whether a Montana resident individual recognizes income for Montana individual income tax purposes on the undistributed income of a foreign corporation that has a valid federal S corporation election, but which does not do business in Montana, and therefore cannot elect under MCA 15-31-202?

CONCLUSION

No. MCA 15-30-111(3) applies to this issue by its plain language and provides that such income is excluded from the shareholder's adjusted gross income. Even if MCA 15-30-111(3) does not apply, there is no authority to attribute the corporation's undistributed income to its shareholders.

I

ANALYSIS OF THE ISSUE

Montana individual income tax is imposed upon the "taxable income" of individuals subject to tax. MCA 15-30-103. "'Taxable income' means the adjusted gross income of a taxpayer less the deductions and exemptions provided for in this chapter." MCA 15-30-101(16). MCA 15-30-111(3) provides as follows (brackets and emphasis added):

> [1] In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect [2] but with respect to which the election provided for under 15-31-202, as amended, is not in effect, [3] adjusted gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S election were not in effect.

There are no other statutes directly addressing this issue. On its face and by its plain language MCA 15-30-111(3) clearly addresses the issue posed here and answers it in the negative. Our issue poses (1) "a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect," (2) "but with respect to which the election provided for under 15-31-202, as amended, is not in effect." The statute then provides (3): "adjusted gross income does not include any part of the corporation's undistributed taxable income . . . ." The only difference between the actual statutory language and the issue posed here is the reason that the corporation in this case has not elected under MCA 15-31-202, namely, that it is ineligible to do so under MCA 15-31-201 because it does not, by assumption, do business in Montana.

MCA 15-30-111(3) does not address the various reasons a corporation may not have filed a Montana S corporation election under MCA 15-31-202. A corporation may not have been eligible as in this case; it may have neglected to make the filing; or it may

have chosen not to elect because it is more advantageous under the respective rate structures to be treated as an S corporation for federal purposes and a C corporation for state purposes.

MCA 30-15-111(3) does not address any of the reasons for not electing S corporation treatment under MCA 15-31-202; it simply sets forth the resulting tax consequences. Accordingly, a strong argument can be made that such reasons are not relevant. If the reasons for non-election were relevant to the application of the rule, they would have been set forth in the statute. When a statute clearly answers a legal question on its face in plain language, there is no justification for speculating on the various cases the legislature may have actually contemplated. The Montana Supreme Court recently stated:

> We first note the general rule of statutory interpretation found in § 1-2-102, MCA, which states that legislative intent controls. Legislative intent is to first be determined from the plain meaning of the words used, and if interpretation of the statute can be so determined, the courts may not go further and apply any other means of interpretation. Boegle v. Glacier Mountain Cheese Co. (Mont. 1989) 777 P.2d 1303, ____, 46 St. Rep. 1389, 1391 (emphasis added).

Similarly, in a recent property tax case the Court recited:

> [T]he well accepted principle of statutory construction that the function of this Court is to interpret the intention of the legislature, if at all possible, from the plain meaning of the words used, and if the meaning of the statute can be determined from the language used, this Court is not at liberty to add or detract language from the statute in question. Department of Revenue v. Gallatin Outpatient Clinic, Inc. (Mont. 1988) 763 P.2d 1128, ____, 45 St. Rep. 2025, 2028 (emphasis added).

Therefore, because MCA 15-30-111(3) applies to the issue at hand in plain, clear language, no further analysis of legislative intent is required or justified.

EXHIBIT 5
DATE 4-4-91
HB SB 333

II

ANALYSIS OF THE MEMORANDUM OPINION

Reference is made to a Department of Revenue Memorandum Opinion, dated October 14, 1987, concerning taxation of gains and losses from out-of-state S corporations. The Memorandum Opinion begins its analysis on page 3 by acknowledging that MCA 15-3-111(3) answers the issue posed here on its face, but the author characterizes such a reading as "strict and technical." Actually, a plain reading gives a plain answer as demonstrated above. If by "strict" the author means limited to its plain meaning, then so be it. It certainly does not require a technical reading to reach the plain result. Any person applying basic plain English logic will get the same result. Only by taking a technical approach can one begin to consider other alternatives. That approach, of course, is contrary to the plain meaning rule adopted by the Montana Supreme Court.

Having thus summarily disposed with the plain meaning approach as "strict and technical," the Memorandum Opinion poses the question: "[W]hether the legislature intended by enacting § 15-31-111(3) [sic] to exclude gains and losses from out-of-state 'S' corporations from the adjusted gross income of Montana residents." The Memorandum Opinion argues that had the legislature intended the statute to apply to the case at hand, namely, an S corporation not doing business in Montana, (1) "it would have been much more clear," and (2) "it could easily have set forth an absolute exclusion of such gains and losses . . . ."

such gains and losses requires an impossibility, then the statute should not be interpreted that way; rather it should be interpreted to require exclusion of gains and losses.

The concept of "impossibility" may be misused here in any case. It is "impossible" for a corporation not doing business in Montana to elect under MCA 15-31-202, and, therefore, impossible for its Montana shareholders to include the gains and losses for such corporation. But that is only to say that the corporation is ineligible. Under Subchapter S of the Internal Revenue Code, it is impossible for any corporation to be a shareholder of an S corporation, but that does not mean that other shareholders of such a corporation should be given S corporation treatment to avoid the "impossibility" of being ineligible. There is no impossibility in this case; there is just ineligibility and a policy decision set forth in plain language that certain tax consequences follow from the absence of an election.

Note also that the requirement of "doing business in Montana" under MCA 15-31-201 makes perfect sense in its context, that is, Chapter 31, MCA concerning the corporation income tax. A corporation is subject to tax only if it is doing business in Montana. MCA 15-31-101. If a corporation is not doing business in Montana, there is no corporation tax, and thus, there is no need to elect not to be subject to it.

III

FURTHER ANALYSIS

At the beginning of the Memorandum we applied MCA 15-30-111(3) and the plain meaning rule of the Montana Supreme Court to the

Concerning part (1) of the argument, it was noted above that there are several reasons why a corporation with a valid federal S corporation election might have no S corporation election in effect under MCA 15-31-202. The legislature chose not to address any of the reasons in the statute. As argued above, this supports the view that the various reasons for non-election are not relevant. The legislature just set forth the tax consequences as a matter of policy. As to part (2) of the argument, the legislature did "set forth and absolute exclusion of such gains and losses . . . ." MCA 15-30-111(3) is absolute; there are no qualifiers concerning reasons for having no election in place.

The Memorandum Opinion then makes the "impossibility" argument as follows:

> In effect, an interpretation that out-of-state "S" corporation gains and losses are excluded by § 15-30-111(3) is interpreting this statute to require an impossibility.
>
> It is a well known maximum jurisprudence that "[T]he law never requires impossibilities." § 1-3-22, MCA. In fact, it is impossible for an out-of-state "S" corporation to effectively elect under 15-31-202, MCA. Therefore, the requirement is nonsensical. The more reasonable interpretation is that the statute only requires an election when the corporation is "doing business" in Montana.

There appear to be several flaws in this reasoning. First, the proposition in the first sentence is misstated. It is only by interpreting MCA 15-30-111(3) to include gains or losses that requires the impossibility, that is, an election by a corporation not doing business in Montana, which ipso facto is not eligible under MCA 15-31-201. But, properly stated, this argument proves the opposite. If interpreting the statute to require inclusion of

current issue and concluded that a plain answer resulted and further analysis was not justified. In the previous Section we analyzed the arguments in the Memorandum Opinion that reached a contrary conclusion and found them wanting. Although we believe the plain language approach discussed in Section I of this Memorandum is dispositive of this issue, others may feel a need for a more technical approach.

Let us assume for the sake of argument that the legislature did not subjectively intend for MCA 15-30-111(3) to apply to S corporations not doing business in Montana; it just did not have this case in mind. The analysis does not end there, however. We must then ask what rule should apply in the case of S corporations not doing business in Montana? Is there a good reason to reach the opposite result as set forth in MCA 15-30-111(3)? Further statutory analysis and the basic principles of income taxation suggest not.

First, even if one assumes that MCA 15-30-111(3) was not originally intended to apply to S corporations not doing business in Montana, the courts frequently and properly apply existing statutes to analogous situations even if the statutes do not directly apply. The existing statutes are the most legitimate source of public policy from which the courts can make law in the absence of a directly applicable statute. MCA 15-30-111(3) is the only statute directly relevant to this case. Accordingly, a court would be more likely to apply this rule than to decide that the opposite rule should apply.

Further analysis of the corporate and individual tax statutes other than MCA 15-30-111(3) also leads one to conclude that undistributed corporate income cannot be attributed to the corporation's shareholders. Because the corporation in this case does not do business in Montana, it is not subject to the Montana corporation income tax as noted above. By what authority then are its Montana shareholders subject to tax on the corporation's undistributed income? There is no statute that requires this. Indeed, MCA 15-30-202 demonstrates that a special statute and an affirmative election are required to attribute the income of a corporation to its shareholders. Thus, unless a special statute provides to the contrary, a corporate entity is respected for tax purposes.

Is there something in Chapter 30, MCA, concerning individual income tax that causes a shareholder to be taxable on a corporation's undistributed income? MCA 15-30-101(7) provides as follows (emphasis added):

> "Gross Income" means the taxpayer's gross income for federal income tax purposes as defined in section 61 of the Internal Revenue Code of 1954 or as that section may be labeled or amended . . . .

MCA 15-30-111(1) provides in part as follows (emphasis added):

> Adjusted gross income shall be the taxpayer's federal income tax adjusted gross income as defined in section 62 of the Internal Revenue Code of 1954 or as that section may be labeled or amended . . . .

IRC § 62(a) provides in part as follows:

> For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions . . . .

EXHIBIT 5
DATE 4-4-91
HB SB 333

The Montana individual income tax is clearly predicated on Section 61 of the Internal Revenue Code. Under the long established principles of IRC § 61, a cash ba ; taxpayer is not taxable on income unless is it actually o constructively received. A corporation's undistributed income is not actually or constructurally received by its shareholders (unless such income were indirectly applied to satisfy the shareholder's obligations, a case not presented here). IRC § 61 does not cause corporation income to be attributed to shareholders; that is accomplished only by the special provisions of Subchapter S of the Internal Revenue Code, IRC § 1366 in particular. Thus, there is no authority under IRC § 61 and derivatively no authority under MCA 15-30-101(7) to attribute a corporation's income to its shareholders.

In summary, this Section has argued that even if MCA 15-30-111(3) was not originally intended to apply to S corporations not doing business in Montana, it should be applied to them anyway as the closest applicable rule.

The last two paragraphs have demonstrated that even if we assume that the statute was not originally intended to apply to the facts of this case, there is no authority for attributing the income of a corporation to its shareholders in any case in the absence of an applicable statute to that effect.

[redacted] Exhibit # 5
4-4-91 SB 333

[redacted] was a regular corporation for income tax purposes and assessed tax, interest, and penalties on the Corporation. (JCCS had filed their Montana corporate return as if it were an S-Corporation). The Department also forced amended returns for all shareholders (see your file on [redacted] for example) to remove items of corporate income, deduction and ITC as shown on the Schedule K-1's from the shareholder's personal returns. We have documentation on all of this in our files.

The bottom line, Denis, is that it appears to me that not only has the Department of Revenue given assurance verbally that our tax treatment is the correct one, but it has demonstrated by its own actions and assessments that we are right. How then can the Department take an opposite stand now?

We feel that we are correct with our views in this matter. We also feel that the Montana Code is clear as it is written and that there is no reason to wait for the next Legislative session to fix something that is not broken. It is black and white, not gray, and the Department agreed with us only a short time ago.

Please advise us as to the status of this situation and I will relay the information on to our clients. Thanks.

Sincerely,

JUNKERMIER, CLARK, CAMPANELLA, STEVENS, P.C.
Certified Public Accountants

K Borglum

Kent A. Borglum, CPA

EXHIBIT C

Exhibit # 5
4-4-91 SB 333

Junkermier · Clark
Campanella · Stevens · P.C.
Certified Public Accountants

Ward F. Junkermier, CPA
George L. Campanella, CPA
Stone E. Paulson, Jr., CPA
Rick A. Frost, CPA
Robert E. Nebel, CPA
Joseph F. Shevlin, CPA
Ronald A. Taylor, CPA
Kent A. Borglum, CPA
Terry L. Alborn, CPA
William J. Eidel, CPA
Walter J. Kero, CPA

May 29, 1990

Denis L. Adams, Director
Montana Department of Revenue
Mitchell Building
Helena, MT 59624

Dear Denis:

Thanks for taking the time during tax season to meet with Tim Wylder and me on the non-Montana S-Corporation taxation issue. We have not heard anything from your department as to the status of your predicament, so we are assuming that your office is still working on it.

So that you know JCCS' position in this matter, I would like to briefly reiterate that we looked into this issue in the fall of 1986. In fact, our time sheets, phone logs and other documents show that our research was substantially done prior to October 12, 1986. When we were reviewing the tax aspects of forming these out-of-state corporations, I (personally) talked to Lynn Chenoweth to (1) confirm our interpretation of the applicable statutes and (2) discuss the character of any distributions taken. It is my understanding that he discussed the issue with someone else in your department prior to his final phone call to me.

Included in our research notes is documentation that this type of corporate setup is also in operation with California shareholders of a Nevada S-Corporation with the identical result your office advised us on; that is, no California tax on the S-Corporation income until the income is actually distributed. The income cannot be reflected on the individual's state tax return because the S-Corporation did not (and cannot) make a valid state S-Corporation election. If the legal opinion set forth by your department's attorney was correct, there would be no reason to need a form or procedure to elect S-Corporation status in Montana, would there?

*** PLEASE NOTE that this issue has been raised by your Department before. We have received permission from another one of our clients to recap the following scenario for you.

[redacted] treasurer for [redacted] filed a Federal S-Corporation election on October 31, 1980. He did not file properly for a Montana election. JCCS did not know about him filing for the election until after he had done it and so assumed he did everything correctly. The Department notified [redacted] in 1982 of the improper filing under MCA Section 15-31-202 and that it did not have a valid election for the fiscal year ended September 30, 1981. The Department concluded that [redacted]

EXHIBIT D

Exhibit # 5
4-4-91 SB 333

COPY

MEMORANDUM OPINION REV/OLA 87-61

TO: Ken Morrison, Administrator
Income Tax Division

FROM: David W. Woodgerd, Chief Legal Counsel
Office of Legal Affairs

DATE: October 14, 1987

SUBJECT: Individual Income Tax - Taxation of gains and losses from out-of-state "sub-S" corporations

ISSUE

Should the gains and losses of an out-of-state "sub-S" corporation which are attributable to Montana residents be included in Montana adjusted gross income?

CONCLUSION

The gains and losses from out-of-state "sub-S" corporations received by Montana residents should be included in their adjusted gross income.

DISCUSSION

As you are well aware, Montana exempts small business corporations from its corporate license tax if they so elect and meet certain criteria.

> §15-31-202. Election by small business corporation. (1) A small business corporation may elect not to be subject to the taxes imposed by this chapter.
> (2) If a small business corporation makes an election under subsection (1), then: (a) with respect to taxable years of the corporation for which such election is in effect, such

> corporation is not subject to the taxes imposed by this chapter and, with respect to such taxable years and all succeeding taxable years, the provisions of this part apply to such corporation; and (b) with respect to the taxable years of a shareholder of such corporation in which or with which the taxable years of the corporation for which such election is in effect end, the provisions of this part apply to such shareholder, and with respect to such taxable years and all succeeding taxable years, the provisions of this part apply to such shareholder.
>
> (3) An election under subsection (1) must be made in accordance with rules prescribed by the department of revenue.
>
> (4) This election is not effective unless the corporate net income or loss of such electing corporation is included in the stockholders' adjusted gross income as defined in 15-30-11.
>
> (5) Every electing corporation is required to pay the minimum fee of $10 required by 15-31-204.

Small business corporations are those corporations which are "doing business in Montana" and have made an election pursuant to subchapter S of Chapter 1 of the Internal Revenue Code. 15-31-201(1), MCA. They are commonly referred to as "sub-S" or "S" corporations.

The gain or loss from an "S" corporation flows through to the individual shareholder for both federal and state purposes and is included in the individuals adjusted gross income. §15-30-111, MCA. However, pursuant to subsection (3) of §15-30-111, MCA, if a corporation which has filed a valid "S" election for federal purposes does not file an election for state purposes as required by §15-31-102, MCA, the gain or loss is not included in Montana adjusted gross income for the individual. Because no election has been filed in Montana the corporation is subject to the Montana Corporation License Tax and the gain or loss will be included in the income of that corporation.

The question which Erv Hall poses in his request for an opinion concerns "S" corporations having a valid election for federal purposes but which do not "do business" in Montana; have no nexus with Montana and therefore are not a "small business corporation"

EXHIBIT 5
DATE 4-4-91
HB SB 333

for Montana purposes. These corporations can not qualify for an election under §15-31-202 because they do not "do business" in Montana. Indeed, because no nexus exists they are not taxable by the state of Montana and have no need to file an election making them exempt from taxation.

A strict and technical reading of §15-30-111(3) indicates that because no Montana election is filed, the gains and losses from an out-of-state "S" corporation received by an individual in Montana would not be included in Montana adjusted gross income.

> §15-30-111(3). In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect but with respect to which the election provided for under 15-31-202, as amended, is not in effect, adjusted gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the said election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S election were not in effect.

It is my understanding from Erv Hall's memorandum of August 18, 1987 and from a conversation with him, that the division policy in the past has been to disallow the deduction of losses from out-of-state. "S" corporations when claimed by Montana residents. Additionally, I understand that in certain cases, gains from out-of-state "S" corporations may have been included in a Montana resident's adjusted gross income.

Also, based upon discussions with Erv, I understand that in the case of partnership income, which is another type of "passive" income, both gains and losses are included as part of an individual resident's adjusted gross income.

It seems clear, as Erv has stated, that the policy and practice of the Department needs to be consistent as between gains and losses from out-of-state "S" corporation income.

One point of view is that since the out-of-state "S" corporation does not have an opportunity to elect under §15-31-202, MCA, the exclusion of gains and losses should not apply. The other point of view is that the statute requires an election and if it is not made, neither the losses or the gains can be included in adjusted gross income.

The issue is whether the legislature intended by enacting §15-31-111(3) to exclude gains and losses from out-of-state "S" corporations from the adjusted gross income of Montana residents. There are no legislative minutes available to use as guidance as to intent. However, it seems clear that if in fact this was the legislature's intent, it would have been much more clear. In other words, it could easily have set forth an absolute exclusion of such gains and losses rather than doing it in such a round-about manner. In effect, an interpretation that out-of-state "S" corporation gains and losses are excluded by §15-30-111(3) is interpreting the statute to require an impossibility.

It is a well known maxim of jurisprudence that "[T]he law never requires impossibilities." §1-3-222,MCA. In fact, it is impossible for an out-of-state "S" corporation to effectively elect under 15-31-202, MCA. Therefore, the requirement is nonsensical. The more reasonable interpretation is that the statute only requires an election when the corporation is "doing business" in Montana. [illegible] effect.

Therefore, it is my opinion that both gains and losses of an out-of-state "S" corporation should be included in a Montana resident's adjusted gross income.

DAW/jb

Exhibit # 5
4-4-91 SB 333

TIMOTHY J. WYLDER

PROPOSED AMENDMENTS
TO
SENATE BILL 333

April 4, 1991

The first clause of the Title to Senate Bill 333 (before the first semicolon) is amended to read as follows:

A BILL FOR AN ACT ENTITLED: "AN ACT FIRST REQUIRING THAT A MONTANA SHAREHOLDER OF A CORPORATION THAT IS NOT INCORPORATED IN MONTANA AND HAS ELECTE" SUBCHAPTER S. CORPORATION STATUS FOR FEDERAL PURPOSES IS S" ECT TO THE SAME INDIVIDUAL INCOME TAX TREATMENT AS A MONTA" SHAREHOLDER OF MONTANA CORPORATION THAT HAS ELECTED SUBCHAP.ER S CORPORATION STATUS; . . ."

Section 11 of Senate Bill 333 is amended to read as follows:

NEW SECTION. Section 11. Effective dates -- applicability. (1) Except for the purposes of subsection (2), [this act] is effective December 31, 1991, and applies to any corporation (and any shareholder with respect to such corporation) that has made a valid election under Subchapter S. of Chapter 1 of the Internal Revenue Code first effective in any tax year beginning after December 31, 1991.

(2) For the purpose of promulgating administrative rules to implement [sections 1 through 11], [this act] is effective on passage and approval.

(3) [This act] reflects the Legislature's specific and focused policy judgement on taxation and tax administration of S. Corporations and their shareholders and therefore shall supersede the provisions of any other act including S. Corporation provisions to the extent that such other provisions, if any, are inconsistent with the purposes of [this Act].

HOUSE OF REPRESENTATIVES

VISITOR'S REGISTER

Taxation COMMITTEE BILL NO. SB333

DATE 4/4/91 SPONSOR(S) Sen. Gage

PLEASE PRINT PLEASE PRINT PLEASE PRINT

NAME AND ADDRESS	REPRESENTING	BILL	OPPOSE	SUPPORT
Carol Schaefer	Self and Jim Wylder			amend
Tim Wylder	Myself			amend
Dave Muller	Dept of Rev	SB333		✓
Tom Harris	Mt Soc of CPAs			✓
Mary Carlson CPA	Self -			Support DOR Amendment
Mark Russell	MT Soc of CPAs	SB333		✓

PLEASE LEAVE PREPARED TESTIMONY WITH SECRETARY. WITNESS STATEMENT FORMS ARE AVAILABLE IF YOU CARE TO SUBMIT WRITTEN TESTIMONY.

Vote: Motion carried 15 to 3 with **REPS. O'KEEFE, REAM,** and **STANG** voting no.

Motion/Vote: **REP. REAM MOVED SB 226 BE CONCURRED IN AS AMENDED.** Motion carried 11 to 9. **Exhibit 6**

DISCUSSION ON SB 333

Motion: **REP. REAM** moved to adopt the DOR amendments to SB 333. **Exhibit 7**

REP. THOMAS asked whether the DOR amendments have as complete a grandfather provision as the other set of amendments offered in SB 333's previous hearing.

Jeff Miller, DOR, said in the past, people made investment decisions on the basis of a law that is being changed by SB 333. DOR amendments state if a person is in compliance with current law, and continue to meet the requirements of filing and paying taxes on the corporate level, that person will be grandfathered. The other set of amendments offered in subcommittee covered a situation which DOR feels is currently outside the law, and dealing with illegal situations is not within the scope of this committee's duties.

Mr. Miller said Montana allows people to choose whether to be taxed at the corporate level or at the individual level. People will have until the end of 1991 to elect the exception that is in current law. After that point, everyone will be on the same level.

Vote: Motion carried unanimously.

Motion/Vote: **REP. REAM MOVED SB 333 BE CONCURRED IN AS AMENDED.** Motion carried unanimously.

REP. STANG agreed to carry the bill on the floor.

DISCUSSION ON SB 93

Judy Rippingale, DOR, said the committee had asked the department to compare the method and amounts collected 10 years ago with the amounts collected by the proposed bill. The department could only go back eight years; the total for the elapsed eight years was an $86,000 difference (slightly over $10,000/year).

Motion/Vote: **REP. McCARTHY MOVED SB 93 BE CONCURRED IN AS AMENDED.** Motion carried 12 to 7.

DISCUSSION ON SB 111

REP. COHEN said SB 111 had been amended in subcommittee and received a positive recommendation.

HOUSE OF REPRESENTATIVES

TAXATION COMMITTEE

ROLL CALL DATE 4/8/91

NAME	PRESENT	ABSENT	EXCUSED
REP. DAN HARRINGTON	X		
REP. BEN COHEN, VICE-CHAIRMAN	X		
REP. BOB REAM, VICE-CHAIRMAN	X		
REP. ED DOLEZAL	X		
REP. JIM ELLIOTT	X		
REP. ORVAL ELLISON		X	
REP. RUSSELL FAGG	X		
REP. MIKE FOSTER	X		
REP. BOB GILBERT	X		
REP. MARIAN HANSON	X		
REP. DAVID HOFFMAN		X	
REP. JIM MADISON	X		
REP. ED MCCAFFREE	X		
REP. BEA MCCARTHY	X		
REP. TOM NELSON	X		
REP. MARK O'KEEFE	X		
REP. BOB RANEY	X		
REP. TED SCHYE	X		
REP. BARRY "SPOOK" STANG	X		
REP. FRED THOMAS	X		
REP. DAVE WANZENRIED	X		

EXHIBIT 7
DATE 4/08/91
HB SB 333

Amendments to Senate Bill No. 333
Third Reading Copy

Requested by Income Tax Subcommittee
For the Committee on Taxation

Prepared by Greg Petesch
April 8, 1991

1. Title, line 15.
Following: ";"
Insert: "PROVIDING A LIMITED EXCEPTION ALLOWING CORPORATIONS THAT CURRENTLY USE SUBCHAPTER S. CORPORATION STATUS FOR FILING FEDERAL INCOME TAX AND REGULAR CORPORATION STATUS FOR FILING MONTANA INCOME TAX TO CONTINUE THAT METHOD OF FILING;"

2. Page 14, line 10.
Strike: "For purposes of this part"
Insert: "(1) Except as provided in subsection (2)"

3. Page 15, line 9.
Following: line 8
Insert: "(2) A corporation that would otherwise be a small business corporation may continue to be subject to the taxes imposed by Title 15, chapter 31, if all of the following conditions are met:

(a) on December 31, 1991, the corporation was doing business in Montana and had a valid Subchapter S. corporation election but had not elected to be taxed as a Montana small business corporation;

(b) after December 31, 1991, the corporation has not filed as a Montana small business corporation; and

(c) the corporation files a corporate license tax return, as required by 15-31-111, reporting all income or loss as determined under Title 15, chapter 31, and attaches a copy of the federal Subchapter S. corporate tax return."

HOUSE STANDING COMMITTEE REPORT

April 8, 1991

Mr. Speaker: We, the committee on Taxation report that Senate Bill 333 (third reading copy -- blue) be concurred in as amended.

Signed: _____
Dan Harrington, Chairman

Carried by: Rep. Stang

And, that such amendments read:

1. Title, line 15.
Following: ";"
Insert: "PROVIDING A LIMITED EXCEPTION ALLOWING CORPORATIONS THAT CURRENTLY USE SUBCHAPTER S. CORPORATION STATUS FOR FILING FEDERAL INCOME TAX AND REGULAR CORPORATION STATUS FOR FILING MONTANA INCOME TAX TO CONTINUE THAT METHOD OF FILING;"

2. Page 14, line 10.
Strike: "For purposes of this part"
Insert: "(1) Except as provided in subsection (2)"

3. Page 15, line 9.
Following: line 8
Insert: "(2) A corporation that would otherwise be a small business corporation may continue to be subject to the taxes imposed by Title 15, chapter 31, if all of the following conditions are met:

(a) on December 31, 1991, the corporation was doing business in Montana and had a valid Subchapter S. corporation election but had not elected to be taxed as a Montana small business corporation;

(b) after December 31, 1991, the corporation has not filed as a Montana small business corporation; and

(c) the corporation files a corporate license tax return, as required by 15-31-111, reporting all income or loss as determined under Title 15, chapter 31, and attaches a copy of the federal Subchapter S. corporate tax return."

MINUTES

MONTANA SENATE
52nd LEGISLATURE - REGULAR SESSION

FREE CONFERENCE COMMITTEE ON SB 333

Call to Order: By Senator Thomas Towe, Chairman, on April 22, 1991 at 11:00 a.m.

ROLL CALL
Members Present:
Senator Thomas Towe, Chairman (D)
Senator Francis Koehnke (D)
Senator Delwyn Gage (R)
Representative Dan Harrington (D)
Representative Jim Elliott (D)
Representative Mike Foster (R)

Staff Present:

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Announcements/Discussion:

EXECUTIVE ACTION ON SENATE BILL 333

Discussion:

Senator Towe led the discussion of the proposed amendments.

Senator Gage stated that the Department of Revenue were primarily trying to alleviate at least one problem with one taxpayer, and maybe with some others who are not here with regard to that. The department has done considerable tax planning in the past with regard to sub "s" corporations that are not Montana corporations and some way or other, grandfather them in at least, so that they will be able to adjust their tax planning over a period of time. There is some indication that these taxpayers have relied on the advise from the Department of Revenue in setting up the situation that they are currently operating under. The Department of Revenue has prepared the suggested amendments to the bill.

Senator Towe passed out the copy of the bill and the proposed amendments.

Dennis Adams, Department of Revenue, stated that there were one group of amendments introduced by the House which the Department of Revenue feels comfortable with as far as allowing taxpayers, that have been filing either "s" or "c", to do business in the state of Montana. But the one area not covered by the House, even though it was discussed with the House Taxation Committee, is the amendment before you now. It is for a taxpayer who is a Montana resident involved in an "s" corporation that does not do business in the state of Montana. Since there is no business done in Montana, it is an individual election as to how they will file because no corporate returns would be filed with the state. There seems to be a dispute as to whether or not the taxpayers have relied upon advise from the Department of Revenue as to how the business should be treated. It would still be up to the staff to determine whether or not there was advice from the Department of Revenue, and whether this advice was used in making their election decision regarding their individual Montana Income Tax returns.

This amendment states if the taxpayer can establish by substantial credible evidence that the Department of Revenue gave the taxpayer advise concerning the application of Section 15-30-111 to the taxpayer's facts and circumstances, then the taxpayer, in that case, would have what is referred to as a "conditional grandfather". The taxpayer would have until December 31, 1996 to change his tax planning, to eliminate confusion in this situation.

Senator Towe reiterated, that the bill itself deals with subchapter "s", elections for out of state corporations.

Mr. Adams explained that what is covered in the bill right now is a consistent way for taxpayers or shareholders of "s" corporations' reporting for Montana purposes. Thirty-seven states already require that if you make out an "s" corporation for federal, then you also have to do so for the state. That is the essence of the bill. There is a grandfather clause in bill for those who have made an "s" or "c" election for state purposes. It would only apply to new taxpayers making elections so that it will be consistent in the future.

Senator Towe asked if that was in the original bill?

Mr. Adams stated that it was, and that the House amendments cover it. That is the grandfather portion of the House amendments.

Senator Towe asked then if any "s" corporation, already having made a valid election in Montana to go "s" will be able to continue "s", even if they are not on the federal?

Mr. Adams stated that what happens usually is the other way around. They file "s" for federal and a "c" for Montana. They will still be allowed to do that. It is especially noticeable if they are an out-of-state shareholder investing in Montana, rather than their only income in Montana. So most prior to file a "c" corporation rather than having fifteen or twenty shareholders have to file individual income tax returns for Montana. So they have elected to be treated as a "c" corporation for state purposes. Montana is getting the taxes either way, either as an "s" corporation or as a "c" corporation.

Senator Towe asked if this proposed amendment that he is proposing would grandfather further a taxpayer who is a shareholder that is not doing business in Montana and has elected an "s" corporation. How does that fit in with what we just said?

Mr. Adams stated that basically the "s" corporation is not doing business in the state of Montana but the shareholders are Montana residents, so for federal purposes they pick up the "s" corporation income on the federal return, but then they back it out as an adjustment for Montana. Usually these are in states that have no other income tax, so they don't get the credit back and forth.

Senator Towe stated that this will allow shareholders, up until 1996, to continue to do this even though the corporation (sub "s") is not doing business in Montana. It will allow them to continue their current practice until 1996?

Mr. Adams stated yes, assuming that the Department of Revenue is successful in its position as it goes through the appeals process.

Senator Towe asked Mr. Adams if the taxpayer can prove that they have obtained advise from the Department of Revenue and, in fact, gave them advise that they relied on as the way to do it, then the taxpayer can continue that practice until 1996, and that is the amendment.

Mr. Adams stated that was correct.

Tom Wilder stated that his amendment is technically different. The department has added a number of elements of gloss to this which concern him.

Senator Towe asked Mr. Wilder if he was satisfied with the department's amendment?

Mr. Wilder stated no. As you read through it the basic structure is the same. The Department of Revenue added some additional language that concerned him like "applicable to the taxpayers facts and circumstances" and "reliance to the taxpayers detriment". His concern is that when the accountant, working on these series of projects, proposed the issue to the department, it may have been in the general question, and how is the Montana resident shareholder of an "s" corporation treated under such and such a section? That was probably how the question was asked as opposed to reciting "taxpayers facts and circumstances" as would be the case.

Mr. Shanahan stated that Montana has literally no procedure for it. Why do we now want to put you under the same specific requirements as if you were requesting it literally? Mr. Wilder's amendment merely says that if we can prove to the satisfaction of the trier of fact, either the tax appeal board or the district court, that the we were given advise and we relied on it, that ought to be the issue rather than getting down to arguing about what does the legislature mean by arguing about facts and circumstances.

One other thing in the title of the bill is that every time there is a clarification of tax laws, it causes a series of supreme court decisions. One specific case is Asarco v. Department of Revenue. The Supreme Court said that this is the way that the Department of Revenue had always done it, and therefore it was not really an amendment to the bill, but merely a clarification. Therefore this application would apply seven or eight years retrospectively because "that is the way the department always did it". In this current case, that is not the way the department always did it. He would rather have the word "requiring" in the title instead of "clarifying".

Senator Towe asked if Mr. Adams if he had any problems with the word "requiring"?

Mr. Adams stated that his only concern is that the Department of Revenue has settled with some taxpayers on this issue and collected dollars from them. The Department of Revenue would have to be careful that having paid on this issue, they would go back against the Department of Revenue.

Senator Towe stated that it is effective December 31, 1991, and applies to tax years beginning after December 31, 1991,

so it should take care of that problem.

Mr. Adams stated that the problem is that these taxpayers are asking for an exemption from that. If they lose, they would have to come in immediately under the clause, in subsection 2. The taxpayer would not get the grandfather, and it would be a contradiction because the Department is trying to let them go until December 31, 1996, but this amendment would be coming in as of December 31, 1991.

Senator Towe asked for an explanation.

Representative Foster stated that he had another meeting to go at 11:00 a.m. He stated that he heard extensive arguments in the subcommittee and Taxation Committee from Mr. Wilder, Mr. Shanahan, and Mr. Adams. Our subcommittee and our committee, as a whole, did not adopt the Wilder amendments. He stated that as he remembers those amendments were not even moved, so they lack support on the subcommittee and in the full committee. He stated that Mr. Adams interprets his amendments as somewhat conciliatory in this regard. Before he left, he voted to adopt the Department of Revenue's proposed amendments, and not to support Mr. Wilder's.

Senator Towe asked Representative Foster if he had any sense of the other two House members, since these conference committees go House by House?

Representative Foster stated that Representative Harrington was chairman of the committee and stated that he hated to speak for either one of them. He didn't remember them expressing support of Mr. Wilder's amendment. He stated that if he sees them he will point them to this meeting.

Mr. Wilder pointed out that there was a lack of coordination before the House hearings. He talked with Mr. Adams about some concepts, and they worked out some things that were acceptable but those have not been communicated to Mr. Miller. Mr. Miller represented the Department of Revenue at the hearings. The Department of Revenue, through Mr. Miller, opposed any consideration of these changes because some additional changes and things had not been worked out. So, he is afraid that Representative Foster could view this as not pulling for it.

Senator Towe stated that they needed to get back to the language. He does not understand what Mr. Wilder's language accomplished that the departments language does not?

Mr. Wilder stated that he is concerned with the words "taxpayers", "facts and circumstances" and "advise to its detriment", that these will be seized upon by at least department hearings officers as imposing requirements that weren't anticipated here.

Senator Towe stated that Mr. Wilder's language says, "if the taxpayer establishes by substantial evidence" that the taxpayer relied on the departments advise.

Mr. Wilder stated that is correct.

Senator Towe stated the other one says, "The taxpayer can establish by substantial credible evidence the Department of Revenue gave the taxpayer advise concerning the application of the same section, to the "taxpayers facts and circumstances" and the taxpayer can establish by substantial credible evidence that he relied on that advise to his detriment." The only thing different is the taxpayer's "facts and circumstances".

Mr. Wilder stated the language also says, "and detriment".

Mr. Shanahan stated that his main concern is just the word "clarifying".

Mr. Adams stated that the Department of Revenue's concern is that these other taxpayers have already settled. This reflects additional dollars from a number of other taxpayers who have the identical circumstance. The Wilder's are not the only ones who are caught up in this situation. If we don't look at the individual facts and circumstances, all of these other people are going to say that they are going to come back at the Department of Revenue. We are trying to make sure that this doesn't just impact the Wilder's. The Department of Revenue has other cases out there where people have also checked with the department. They may have taken our advise or they may have called in and checked with the department without giving any facts and we went with them.

Senator Towe stated that makes sense. What if they used the word "requiring" and keep the words "facts and circumstances"?

Senator Gage asked if legally there was any difference between "substantial" and "substantial credible"?

Mr. Shanahan stated not really.

Senator Towe stated that he didn't feel that was a problem if they use "substantial credible evidence" like the Department of Revenue proposed. In other words, if we use exactly the Department of Revenue's language with the only difference being that they change the word "requiring" instead of "clarifying" in the title. That seems to meet everybody's concern. Senator Towe asked if Senator Gage was comfortable with that?

Senator Gage stated Yes.

Senator Towe asked Senator Koehnke if he was comfortable with that.

Senator Koehnke stated yes.

Senator Towe stated that he would write it up and talk to the absent members. If there are two of the House members disagreeing, they have a problem and he will have to call them back. If they agree, it will be circulated to have it signed.

All agreed.

Adjournment At: 11:30 A.M.

Thomas E. Towe
TOM TOWE, CHAIRMAN

Sherry Casey
SHERRY, CASEY, SECRETARY

TT/sc

Free Conference Committee
on Senate Bill No. 333
Report No. 1, April 23, 1991

Mr. President and Mr. Speaker:

We, your Free Conference Committee on Senate Bill No. 333, met and considered Senate Bill No. 333 (reference copy - salmon) and recommend that Senate Bill No. 333 (reference copy - salmon) be amended as follows:

1. Title, line 5.
Strike: "CLARIFYING" on line 5
Insert: "requiring"

2. Page 21
Following: line 1
Insert: "NEW SECTION. Section 11. Conditional Grandfather Clause for certain Montana Shareholders of Foreign Corporations that have elected S corporation status for federal tax purposes. A Montana taxpayer who is a shareholder in a corporation that is not doing business in Montana and has elected S corporation status for federal tax purposes can apply Section 15-3-111(3) (1989) for all tax years beginning on or before December 31, 1996, if the following conditions are met:.

(1) The taxpaper can establish by substantial, credible evidence that the department of revenue gave the taxpayer advice concerning the application of Section 15-30-111(3), to the taxpayer's facts and circumstances.

(2) The taxpayer can establish by substantial, credible evidence that he relied on that advice to his detriment."
Renumber: subsequent sections
And that this Conference Committee report be adopted.

For the Senate:

Chair, Sen. Towe

Sen. Koehnke

Sen. Gage

For the House:

Chair, Rep. Harrington

Rep. Elliot

Rep. Foster

4/1-23-91
Amd. Coord.

4/23
Sec. of Senate

ADOPT

REJECT

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